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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 87/131

3:00 p.m., September 4, 1987

M. Camdessus, Chairman

Executive Directors	Alternate Executive Directors
A. Abdallah	
Dai Q.	
C. H. Dallara	M. K. Bush
	L. Hubloue, Temporary
A. Donoso	
	M. B. Chatah, Temporary
G. Grosche	B. Goos
	J. Reddy
	J. E. Zeas, Temporary
	M. Foot
M. Massé	
Mawakani Samba	C. V. Santos
Y. A. Nimatallah	A. Ouanes, Temporary
G. Ortiz	L. Filardo
J. Ovi	M. Fogelholm
	D. Marcel
	G. Pineau, Temporary
G. A. Posthumus	
	C.-Y. Lim
G. Salehkhou	O. Kabbaj
	L. E. N. Fernando
	A. Vasudevan, Temporary
K. Yamazaki	M. Sugita
S. Zecchini	

L. Van Houtven, Secretary and Counsellor
R. S. Franklin, Assistant

Also Present

IBRD: D. R. Bock, Director, Debt Management and Financial Services Department. African Department: P. Marciniak. European Department: M. Guitián, Deputy Director. Exchange and Trade Relations Department: J. T. Boorman, Deputy Director; S. J. Anjaria, A. Ariyoshi, C. Atkinson, E. Brau, K. B. Dillon, L. H. Duran-Downing, J. Hicklin, H. B. Junz, S. Kanesa-Thasan, G. R. Kincaid, D. A. Lipton, P. J. Quirk, K. P. Regling, L. M. Valdivieso, C. M. Watson, M. Xafa. External Relations Department: A. F. Mohammed, Director; D. M. Cheney, P. C. Hole, H. Puentes. IMF Institute: O. B. Makalou. Legal Department: J. M. Ogoola. Research Department: J. A. Frenkel, Economic Counsellor and Director; A. D. Crockett, Deputy Director; M. Goldstein, Deputy Director; R. R. Rhomberg, Deputy Director; M. P. Dooley, D. Folkerts-Landau, D. M Mathieson. Secretary's Department: C. Brachet, Deputy Secretary. Western Hemisphere Department: S. T. Beza, Director. Bureau of Statistics: C. Briançon. Personal Assistant to the Managing Director: R. M. G. Brown. Advisors to Executive Directors: P. E. Archibong, A. Bertuch-Samuels, L. P. Ebrill, A. G. A. Faria, G. D. Hodgson, A. R. Ismael, P. Péterfalvy, I. Puro, N. Toé. Assistants to Executive Directors: F. E. R. Alfiler, H. S. Binay, E. C. Demaestri, F. Di Mauro, S. K. Fayyad, V. J. Fernandez, M. A. Hammoudi, M. Hepp, Hon C.-W., K. Kpetigo, M. Lundsager, T. Morita, C. Noriega, L. M. Piantini, S. Rebecchini, S. Rouai, H. van der Burg, D. A. Woodward, Yang W., I. Zaidi.

1. FINANCING FOR COUNTRIES WITH PAYMENTS DIFFICULTIES; INTERNATIONAL CAPITAL MARKETS AND OFFICIALLY SUPPORTED EXPORT CREDITS - DEVELOPMENTS AND PROSPECTS

The Executive Directors continued from the previous meeting (EBM/87/130, 9/4/87) their consideration of staff papers on recent experience with, and possible adaptations of, financing for countries with payments difficulties (SM/87/190, 7/31/87) and on developments and prospects in the area of international capital markets (SM/87/194, 8/5/87) and in the use of officially supported export credits (SM/87/195, 8/5/87; and Cor. 1, 8/13/87). They also had before them papers on capital market financing for developing countries (SM/87/207, 8/17/87) and on international banking activity in the first quarter of 1987 (SM/87/209, 8/12/87).

Mr. Posthumus made the following statement:

Because I am convinced that a general solution to the debt problem--which is not even a general problem--is no solution, I have also become convinced that we should stop searching for the philosophers' stone. In avoiding such a search, I have prepared no comprehensive statement and have chosen to focus my remarks only on the 15 heavily indebted middle-income countries and not on the low-income countries. The latter are indebted as well, but for them, official creditors are relatively much more important. We have the "debt strategy" on the agenda of the Interim Committee, rather than the debt "strategies." We thus create the impression that there is an overall approach (a collaborative strategy) which is more than, or adds to, the case-by-case approach to the debt problem. This impression is right when we look to the past. But, as is usual in strategies, we should look into the future. How is the strategy evolving? Does the debt strategy, both as it is worded and as it is carried out, have general elements which do not help or which might hinder case-by-case solutions?

Elements of the debt strategy are the necessity (1) that debtor countries adjust; (2) that banks provide new financing; (3) that the Fund plays a central role; and (4)--the aim of all this--that normal relations between debtors and creditors are restored.

If we look into the element of the strategy which asks banks to provide new financing, then it is also clear that principal and interest on existing debts must be paid. And this is in line with the strategy's ultimate aim of restoring normal relations between debtors and creditors. Yet we all know that in some cases where there can be no doubt that the debtor wants to make his principal and interest payments, he does not do so because he cannot do so. In these cases, the normal relations between debtors and creditors need not necessarily be destroyed. Such cases can be handled with a range of measures from rescheduling principal for one to two years to far-reaching solutions like buy-back arrangements. Banks can even write off the debts, or a part of the debts, and maintain normal relations with the debtor. Clearly, they will do this only if, from their point of view, such action contributes to a restoration of relations with a debtor which is adjusting and laying the basis for future growth, although they should not forget that lending to present debtors was known to be at unsustainably high levels when that lending was effected. The need for debt relief can only be discussed in conjunction with credible adjustment policies and only by and between creditors and debtors. But normal relations can exist or be restored even if a part of the debts will never be repaid.

The present strategy, based on the idea that banks should provide new financing, implies that new debts should be piled on existing debts. This is a general approach, suited to the 1982 situation but less so to the present situation; and it may in some cases hinder discussions about debt relief as a contribution to solving the problem. In reality, we see that new financing is no longer the main instrument in the strategy. And we see that new approaches are developing, albeit slowly, and that debt relief can be part of these new approaches.

Another element in the strategy is the role of the Fund. The central role of the Fund has been, since 1982, in fact a dual role: assisting a deficit country in the process of its adjustment toward a sustainable situation; and trying to organize the total of capital flows from lenders--in particular, the banks--to the debtor country. This latter part of the dual role was innovative and temporary, because it was set up in particular to help avert a systemic crisis in 1982. The result is that there is a much smaller threat now, or even no such threat at all; the banks are stronger and the debtor countries are in a better situation. The question now is whether the central role of the Fund in this latter, capital-organizing aspect, has a general element to it that might hinder solutions in some cases. Can the Fund, for example, initiate innovative approaches like debt relief in one case without creating a worldwide precedent for other cases? Can the Fund in its capital-organizing role advise debt relief as a possibility to decrease the need for new foreign capital, for example, in a situation in which, notwithstanding good adjustment policies, payment of principal and interest is too heavy a burden? It seems to me quite possible that banks or official creditors may be unable or unwilling to see this or may even think that it is not their responsibility to find a solution. They may think that the Fund itself or the World Bank or creditor governments should provide more funds, and that the IMF should organize this. Thus, there may be situations where the role of the Fund as a capital organizer can hinder the working out of solutions between debtors and creditors. However, the case-by-case approach means that debtors and creditors should carry the full responsibility for solving their problems. It would then be better if the Fund in such cases were to return to its classic role, which is lending to assist adjustment. The Fund would stand, as it were, on the side of the deficit country on the condition of strong adjustment policies. The Fund could devote more attention to the problem of assuring a reasonable apportionment of the dividend of adjustment (if it is undertaken) between the country which it assists and the country's creditors. By concentrating on that role, the Fund might strengthen the adjustment effort, which includes finding a balance between adjustment and financing, and which is so vital for solving the debt problems in a sustainable manner.

I hesitate to draw conclusions from my remarks. However, I think that we should strengthen the case-by-case approach and that we should therefore not try to formulate new general guidelines. The evolution of the debt strategy in the direction of a multitude of debt strategies, including a multitude of solutions--some of which now seem taboo--appears to me to be the right evolution and the only way to prevent fear of setting precedents from paralyzing the adoption of innovative solutions. This raises difficult questions. Can we take away existing obstacles? Can we prevent the construction of new obstacles? And can we create a climate in which the whole process accelerates?

The trouble with this subject is that one would really like to find that "magic stone" which would change metal into gold, and one feels dissatisfied not having found it. But we also have no general guideline for adjustment and development, and that is a consolation. Finally, with regard to the other document on the agenda, my authorities are particularly satisfied with the paper on officially supported export credits. The few remarks they have are of a technical nature and will be communicated through the Secretary to the staff.

Mr. Yamazaki made the following statement:

I thank the staff for the comprehensive, informative, and excellent paper on recent developments in the international capital markets. The analysis of the recent trend in international lending through bank and bond markets well illustrates the developments and problems emerging in the market.

A rapid increase in total lending through international bank credit and bond markets has continued, and almost doubled in 1986. Despite this generally favorable outcome, a sharp contrast has emerged between developments in the industrial countries and those in the developing countries and within the developing countries themselves. Indeed, this surge in net lending in 1986 was fully attributable to the activity among industrial countries, reflecting further financial liberalization and financial imbalances among those countries.

On the other hand, developing countries repaid net $2 billion to private creditors. Looking more closely, we can find that the 15 heavily indebted developing countries repaid net $3.5 billion in 1986, while those developing countries without recent debt-servicing problems got the positive net bank lending, which amounted to $6.8 billion for the same year. These contrasts in developments give rise to concern and might even provide lessons about the current debt strategy. Therefore, let me direct my comments to the developments in lending to the developing countries in the context of the debt strategy.

I believe that the growth-oriented strategy on a case-by-case basis is valid. Adjustment programs should be designed to help countries get back on the path to long-term sustainable growth. To achieve this purpose, it will be important to secure a certain level of effective investment. Indeed, as the *World Economic Outlook* points out, in the late 1970s and early 1980s the countries currently with debt service problems responded to the sharp losses in the net flow of real resources from abroad by mainly cutting investment, while in the case of countries currently without such problems, the burden was shared between investment and consumption.

The question arises how to avoid underfinancing necessary investment. One answer might be to increase the concessionality of the resources from abroad or to seek proportionately large contributions from the official community. This approach may be appropriate for some low-income countries, for which the further accumulation of debt on commercial terms is not considered a realistic solution.

However, it is also commonly acknowledged that such an approach cannot generally be applied to other than those countries. I believe that if countries in the latter category with debt service problems--mainly middle-income countries--seek to regain the path toward long-term sustainable growth, they must restore normal debtor/creditor relations and re-establish normal access to the capital markets. In this context, adjustment efforts of countries with such problems are most important.

Several facts seem to support this idea. On the borrowing side, as I mentioned earlier, those developing countries without debt-servicing problems continue to enjoy normal access to the world capital markets. Furthermore, the actual net repayments by the heavily indebted countries last year were concentrated during the periods when those countries were not pursuing internationally endorsed economic programs. On the lending side, many banks, having built up reserves and capital, seem to be now in a much stronger financial position to extend new credit to troubled countries than they were when the debt problem emerged in 1982. In addition, competition among export credit agencies has recently intensified. Taking into consideration these facts, I urge the countries with such problems to continue to strengthen their adjustment efforts. I stress that these efforts should never be relaxed, even in the face of further buildup of banks' reserves or the reduction of banks' exposure through the debt/equity conversion scheme, matters on which I will comment later.

Remarking on developments in bank lending, I note that the recent reluctance of banks to lend to countries with such problems, and weak bank cohesion, have been matters of concern. U.S. banks have substantially reduced their liabilities to developing countries; at the same time, however, some favorable developments have been achieved. One major favorable development is the evolution of financing techniques. Recently, a menu of options has evolved that will, I hope, make it easier for reluctant banks to enter into the financial package at an early stage. One typical example is the case of Argentina, which has enjoyed the fruits of this menu approach. I strongly welcome developments in this area, and hope that this imaginative approach will be pursued further.

Having said that, however, we should not overlook some problems in the existing menus. For example, debt/equity conversion might tend to make it difficult for the authorities of the debtor countries to exercise proper monetary control. As regards the exit bond scheme, a problem might arise in how to share smoothly among other banks the additional burden that some banks escape by acquiring exit bonds. In any event, we have to continue to monitor the development of the menu of options with caution.

The Fund should continue to play the pivotal role in the debt strategy. The disbursements of bank concerted lending are still tightly linked to implementation by debtor countries of policy programs supported by the Fund. In the circumstances, the Fund should continue to emphasize its role as a catalyst by assisting member countries to design growth-oriented adjustment programs and by monitoring them, rather than by becoming a major provider of required financing.

We should not forget to address the important role of direct foreign investment, which sometimes has much advantage over bank lending. Recent debt/equity conversion schemes certainly seem to facilitate direct investment, which I highly welcome. But I note that, fundamentally, in order to attract direct foreign investment, the re-establishment of business confidence through the steady implementation of adjustment programs and some structural reforms--such as liberalization of the trade system or foreign exchange allocation system--are called for. In addition, the Multilateral Investment Guarantee Agency must have a positive influence and encourage investors in this area. All in all, the improvement of the investment environment by the debtor countries themselves is the key element for increased direct investment.

As regards officially supported export credit, it is an encouraging sign that the agencies are now taking a more open stance. But export credit is not an exception, in a sense that contrasts in development are also seen in the export credit between countries with problems and those without. Again, sufficient effort by the authorities to normalize the debtor/creditor relationship is the key variable for the cover policy. In addition, the appropriate assessment and implementation of the investment program has become another important variable when we take into account the agencies' attempt to ration exporter demand within the exposure ceiling. In this context, the large involvement of multilateral development banks in investment programming is highly welcome. At the same time, we should not forget the important role which the debtor countries themselves should play in this area.

In concluding, I am tempted to say that strengthened efforts of the international financial community to ensure that resources are used in a productive way have resulted in sharp contrasts in borrowing availability among developing countries. Having said that, however, despite the recent unsatisfactory developments in lending to debtor countries, the environment surrounding debt problems seems to have somewhat stabilized, compared with the environment some four to five years ago. Therefore, I am inclined to take a more or less optimistic view on the manageability of this problem in the medium term, if due cooperation of developing and industrial countries, as well as of the international financial community, can be properly maintained.

Mr. Vasudevan made the following statement:

The set of papers on international capital markets and financing of countries with payments difficulties show that over the past 18 months or so, developing countries have obtained no net financing in international bank and bond markets. Bank lending to these countries was probably negative. Concerted lending, and net export credits, too, declined in substantial proportions. It is, therefore, not surprising to find that the external debt of developing countries has increased, to $1,100 billion in 1986 from $1,000 billion in 1985, as the latest World Economic Outlook estimates show. Although the average spreads under restructuring agreements declined for all developing countries put together, they remained high in respect of some recent reschedulings in Africa. The average time that elapsed between the first approach to banks and the first disbursement under a new bank money loan increased to eight months in 1986, from five months in 1982-84. Disbursements under the new concerned lending packages of banks are generally phased in line with World Bank disbursements or purchases under Fund arrangements. The Fund involvement is usually insisted on, in almost all cases of reschedulings of maturities;

this involvement in certain cases has been in the form of enhanced surveillance procedures being adopted by countries in need of debt reschedulings.

These facts, taken from the staff papers, demonstrate that the resolution of the debt problem is not yet in sight. In fact, the outlook for lending to developing countries has deteriorated, as shown by examination of the movements in interest rates and trends in export markets in industrial countries and the desire of banks to minimize their exposure to indebted developing countries.

Yet, there was a large surge in total lending in international bank credit and bond markets in 1986, entirely due to activity in industrial countries. While financial liberalization has promoted large capital flows among industrial countries and has facilitated the financing of fiscal and external current account deficits in some of the industrial countries, shocks relating to movements in interest rates and exchange rates as well as certain instruments (such as the recent near collapse of the floating rate note market) cannot be totally ruled out. Besides, pursuit of independent monetary policies would in the event of large financial integration, be rendered difficult in these countries. It would be necessary for industrial countries to bring about policy coordination, so that the risks of the shocks are reduced. The staff has clearly recognized this aspect, but it needs to be given a greater emphasis, given the possible divergences in the speed of adjustment between financial markets and goods markets, and given the unsustainable external positions among industrial countries in the medium term, as we had seen in our last discussion on the use of indicators and as we will notice in our prospective discussion on the world economic outlook. And as Mr. Abdallah has indicated, Fund multilateral surveillance could be of help in promoting policy coordination.

The perceptions of banks on the debt situation make for interesting reading. The key reason, the staff notes after discussions with banks, for the continued aversion of banks to "generalized exposure increases lies in a lack of confidence that most debtor countries will be able to sustain, over an extended period, policies sufficiently strong to restore their full creditworthiness, given the downside risks in the economic policy environment in the industrial countries" (page 11, SM/87/194). Why such a lack of confidence exists is not explored, which is somewhat curious considering the fact that there is, in most cases of reschedulings, some kind of Fund involvement. Is it that the banks find the Fund involvement not adequate? The answer seems to be a partial "yes," in that the banks have stressed that they "will clearly seek proportionately larger contributions from the official community, including from the Fund, the World Bank, the Paris Club, and creditor government agencies" (page 14, SM/87/194). Banks particularly expressed concern about net Fund repurchases by developing countries and suggested that the move away from extended arrangements toward more stand-by arrangements had tended to shorten the maturities of countries' obligations to the Fund. It appears that banks have not made any adverse comment on the kind of policy programs pursued by debtor countries in agreement with the Fund. This gives the impression that so long as the Fund is satisfied with the progress in policy packages, banks will have little to complain about, and that the concerns therefore are limited chiefly to the distribution of financing gaps among different creditor contributors.

Given the limited managerial and technical skills of developing countries to borrow from financial markets that have become far too sophisticated and that are characterized by competition for funds from both industrial countries and banks alike, the provision of adequate financing of the external payments deficits of developing countries assumes as great an importance as the strength of the policies pursued by developing countries. The staff, in yet another paper, SM/87/190, arrives at this conclusion when it states that while strong adjustment policies will remain the cornerstone of the debt strategy, "political support for such policies needs to be underpinned by the provision of adequate financing on realistic terms" (page 9). The staff also points out that, generally speaking, the flow of official financing from multilateral development banks and bilateral creditors should continue to expand, and for some low-income countries, concessional flows--largely from official sources--will be needed. Paris Club creditors seem to be considering the ways by which the low-income debtor countries could be helped. The staff has indicated its view--which is a welcome one--that bank creditors, who have generally resisted direct debt relief, may also find it more desirable to vary their treatment in a limited number of special cases than risk provoking a more widespread buildup of payments arrears. In this context, we would urge a generous replenishment of IDA, which would help minimize the debt-servicing burden of low-income countries. The G-24 report on the role of the Fund in adjustment with growth has suggested that the Fund should, in the case of low-income countries, increase access to its own resources, extend the maturity period of its loans and provide concessionality on its loans. This is a point worth further examination.

In regard to the debt strategy pursued so far by countries which are indebted predominantly to commercial banks, the different variants have not so far provided the expected or desired results. While diversification of lending options would assist in the provision of bank finance, it would not reduce the debt overhang by any significant margin. A number of approaches, including the debt conversions to equity or local currency, have been prevalent, but they have offered only partial solutions, as the staff has correctly pointed out. Even the much heralded menu approach has important limitations, as the staff paper on international capital markets, indicates on page 17. It appears that the assumption of additional debt will be important in financing the process of adjustment. The G-24 report notes that the Fund would have to adopt a debt reconstruction approach to the debt problem, and suggests that "appropriate debt relief formulas of private and official debt should be discussed, including the capitalization of interest and gradual write-off over time of any resulting debt overhang."

An observation on page 10 of SM/87/190 gives the impression that the Fund has very limited options in the resolution of the problem. The staff states: "While the Fund needs to respond flexibly and imaginatively to the problems of its members, it cannot do so without the strong commitment and financial support of other parties to the debt strategy." This could be interpreted by some to mean that the degree of the Fund's response to the problem is conditional on what it determines as the requisite support of other parties. But this need not be so. One could envisage conditions under which the Fund's own response could be positive. This is because the Fund has some usable resources and it can put in place borrowing arrangements. Its quotas could also be increased to meet the financial requirements of needy members. Again, there could be a fresh allocation of SDRs. Some observers have argued on different occasions in the past that the Fund could also in certain circumstances dispose of a portion of its gold holdings for a capital gain; and the proceeds arising from such gains could be used to assist low-income developing countries. The Fund could, in drawing up programs, give priority in appropriate cases to critical imports over the payment of interest, particularly when new loans cannot be easily arranged.

In regard to officially supported export credits, we welcome the open stance that export credit agencies have adopted in recent years. However, some relaxation in resumption of cover and in the terms of credit for countries that are facing payments difficulties but that are prepared to undertake the requisite adjustment policies would be helpful, particularly when assessments of multilateral development banks are available to the export credit agencies in regard to project selection and investment decisions.

Mr. Massé said that he had found the report on export credits to be comprehensive and of high quality. Export credit agencies had adjusted to the debt problem in a number of ways. In addition to an increase in flexibility at the Paris Club, short-term credit lines were being kept increasingly open, and there had been a restoration of access to medium-term credits for countries that had successfully completed rescheduling and had put in place credible and sustained adjustment measures. The maintenance of the cut-off dates within the Paris Club had been of particular importance in restoring cover. Perhaps the most important point was that the volume of new medium-term credit was driven by demand in developing countries, not by the availability of supply. There were, however, real limits to the extent to which official export credit agencies could provide financing in cases where investment demand had declined. He agreed with those who felt that statistical inadequacies existed in that area, and that creditor governments and export credit agencies needed to do more to close those gaps.

Mr. Pineau made the following statement:

> The developments which have taken place since our last review of the debt strategy (EBM/87/50 and EBM/87/51, 3/18/87) tend to confirm some trends. The restrictive stance of commercial banks toward countries with payments difficulties is becoming a lasting feature, even if some flexibility has been introduced through the diversification of innovative options. The multilateral organizations are assuming a central role which could, it is hoped, imply more financial involvement on the part of the Fund. In the financial markets, liberalization and innovation remain key features. The specific responsibilities of national authorities are always to preserve a stable and open international economic environment.
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> Turning to possible adaptations of the debt strategy I note that after the severe strains experienced at the beginning of this year, the cooperative approach to the debt problem has been consolidated, thanks to increased flexibility on the part of all the major players. However, even if some innovative techniques can help accommodate the differing interests of creditors, the scope of this new trend should not be overestimated. First, some regulatory provisions can act as a serious constraint in certain creditor countries; second, some of the basic principles of the debt strategy, such as the case-by-case approach and a comparable involvement of all parties concerned, remain valid.
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> The adaptations that could be introduced are likely to be a mere development of some recent innovations such as debt/equity schemes, discounted debt buy-backs, or exit bonds. A more widespread use of these new instruments can take place only in the context of a consensus between debtor countries and creditors. Furthermore, it must be clear that the main objective of this innovative approach is to facilitate and, hence, increase the financial contribution of commercial banks, along with other creditors.
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> However, as rightly stressed by the staff, the provision of new financing at market conditions should be predicated on the countries' ability to resume a sustainable growth process, after undergoing the required structural reforms. The most recent innovations should then be examined, keeping in mind the distinction between the countries for which an increase in external debt on commercial terms can be envisaged and the debtor countries which qualify for official development assistance.

More specifically on the various instruments currently developed, the debt/equity conversions may prove an interesting mechanism to the extent that some conditions are fulfilled. Just to note two of them: the investment flow stemming from debt/equity conversions should come as an addition to, and not as a substitute for, other potential foreign investments; moreover, such a scheme is counterproductive if it results in a virtual freeze of all the other financial flows between the debtor country and its creditors.

The scope of buy-backs, at discounted rates, seems even more limited. As exemplified by the case of Bolivia, some of the conditions needed do not appear easily repeatable: a rather small and homogeneous group of creditors, the existence of potential contributors not necessarily motivated by financial considerations, and the provision by the Fund of some kind of technical assistance. Such a financial scheme may prove workable, but it is still clearly at an experimental stage.

In the area of export credit policies, one can observe some limits to the new flexible approach. A significant number of institutions are still reluctant to pursue or to resume the granting of guarantees to certain countries with payments difficulties. In fact, as noted in the staff paper, many delays in the re-establishment of coverage are attributable to the finalization of bilateral rescheduling agreements.

However, other reasons which are put forward to account for this situation are less acceptable, such as the apparent decline in fundable projects or the fact that export credits are not the most appropriate type of financing for low-income indebted countries. On the first argument, the export credit agencies should adapt their procedures to new export markets, and some have already engaged in this effort. Also, it must be recalled that, along with concessional flows, these export credits provide an essential financial support, which should not be discontinued without due consideration.

On rescheduling procedures, I would like to reiterate that my authorities favor the stretching out of consolidation periods, especially for the poorest countries. Nonetheless, they are not ready to envisage the granting of concessional interest rates on rescheduled commercial loans. They consider that the relief provided to the poorest countries would be marginal, compared with the relief resulting from a longer grace period. Moreover, it could have an adverse impact on future credits.

As far as the multilateral institutions are concerned, the staff is right to stress the substantial increase in the financial involvement of the multilateral development banks. This is crucial to the extent that it is accompanied by the implementation of significant structural reforms in highly indebted countries. In contrast, the financial withdrawal of the Fund has continued. However, the initiative recently launched to enlarge the structural adjustment facility could put an end to this trend. My authorities fully support this move. Moreover, they note with great interest several indications included in the staff paper according to which the overall financial involvement of the Fund should be reconsidered in light of the latest developments in the debt situation. This is exactly the line of reasoning of my authorities and, as a natural consequence, they are of the view that the multilateral organizations, the Fund as well as the World Bank, must be equipped with adequate financial means.

Turning briefly to capital markets, I want to reaffirm my authorities' commitment to the opening up and rationalization of financial markets. The new institutional setting that is gradually emerging from this liberalization process is not immune to systemic risks and, even if it proved rather resilient, a high degree of vigilance is required. Apart from the regulatory and prudential frameworks, which have to be further harmonized and continuously kept under review, the national authorities must assume responsibilities of a more macroeconomic nature.

The best way to prevent large fluctuations in key variables is for major countries to coordinate their financial policies. Noticeable progress has been made in this direction, but the largest industrial countries still have to produce a significant contraction in the external imbalances, which continue to feed huge financial flows. A second point rightly emphasized by the staff has to do with the maintenance of an open, worldwide economy. In this area, also, a closer coordination among the main industrial countries is required to prevent the disruptive effects which would result from a major contraction or redirection of trade flows.

Mr. Ouanes made the following statement:

The papers before us demonstrate that the trends which have been observed in international capital markets over the past few years have continued, and in some respects have become more pronounced. These trends include the ongoing process of financial innovation and liberalization as well as trends in the pattern of financial flows between major countries and groups of countries. A number of interesting and, in some cases, worrisome asymmetries have emerged from these patterns. First, there is a clear asymmetry between net lending among industrial countries and net lending to developing countries as a whole. Within the group of developing countries, there is a further asymmetry between the financial experience of those countries with payments difficulties and those without recent debt-servicing problems. Also, there is an asymmetry between the experience of the so-called systemic countries and that of the smaller indebted countries. However, the most striking asymmetry, in my judgment, is that between the level of, and trend in, trade restrictions on the one hand, and the level of, and trend in, financial liberalization on the other.

These trends have implications for the management of the debt strategy and for the role of the Fund in that connection. First and foremost, the rise in protectionism is undermining indebted developing countries' efforts to service their obligations by increased exports. The debt profile of developing countries is such that they need to generate significant increases in export revenues over the next few years if they are to keep the service of their debt manageable. I emphasize the need for increased exports because the alternative of further import compression on their part would not be compatible with a return to growth with adjustment. If these countries now find access to industrial country markets to be restricted, this approach to debt servicing is doomed to failure. On a related point, protectionism is particularly damaging to developing countries because of the increase in financial liberalization and innovation which has, rightly, been a subject of so much favorable comment. Notwithstanding the obvious and real benefits associated with that innovation, commercial banks, because of the increasing menu of financial instruments available to them, are able to react to developments on the trade front by reducing their exposure in those developing countries whose trade prospects have become more clouded. I would emphasize that this is very much a second-best situation. That is, the developing countries find their growth prospects and ability to service their debt stymied, while the commercial banks, although they can reduce exposure, can only do so at a high price. In other words, with heightened international financial integration, the net effect of increased protectionism is self-defeating.

What role can the Fund play in light of these developments? There is no question in my mind that the issue at hand is a systemic one. It is closely intertwined with the conduct of macroeconomic policies in the industrial world, with the level of protectionism and, indeed, with the vulnerability of the international monetary system itself. It is important for the Fund to play an active role in the context of its multilateral surveillance to ensure that a global downturn in economic activity is avoided. In the case of the major industrial countries, I feel that the Fund has a delicate task because, on the one hand, the Fund should continue to encourage the present commendable efforts by those countries to reduce imbalances and remove distortions. On the other hand, it is important to ensure that this process of adjustment does not precipitate a global downturn in world growth, or a resurgence of inflation and high interest rates. The question in my view boils down not so much to the thrust of the economic policies as to the speed and timing of adjustment in the major countries concerned.

In the case of indebted developing countries, the Fund could be helpful in at least two important respects. First, the Fund should continue its effort to improve program design and to emphasize growth-oriented policies. The design of Fund programs should also pay increased attention to the social impact of the adjustment process. Second, the Fund, through its catalytic role, can ensure that appropriate and adequate resources from official and commercial sources are made available in support of adjustment programs. In this context, I have some reservations about the view of the commercial banks as presented on page 15 of SM/87/194. The commercial banks seem to feel that it is for the Fund to provide additional resources. This seems to miss the point. For middle-income countries, the objective is to help those countries regain spontaneous access to private capital markets. This requires the cooperation and support of the commercial banks and is an evolving process, as demonstrated most recently during our consideration of the case of Colombia. For the low-income countries, where access to private capital markets might not even be advisable let alone feasible, the Fund is proposing to strengthen its contribution through an enhancement of the structural adjustment facility.

For their part, indebted developing countries need to sustain their adjustment efforts. I am pleased in this connection to read that in 1986, the current account deficit in non-fuel exporting countries was more than halved. It is only through determined and resolute efforts that these countries will be able to regain the confidence of donors, creditors, and, more important, private sectors at home and abroad. However, one must recognize that, unfortunately, sooner or later, in the absence of positive results, adjustment fatigue sets in.

In conclusion, recent developments in the debt strategy have clearly shown that the resolution of the problem will involve a considerably longer-term effort and will require appropriate economic policies, in both the industrial and the indebted countries. We continue to believe that the underlying strategy remains basically sound. Such a strategy has proved sufficiently flexible and dynamic. However, its success will more and more hinge on sustained global growth, enhanced policy coordination among the major industrial countries and, above all, increased access to industrial country markets. I emphasize the last point, because I see in protectionist pressures the one negative factor which could stymie all the positive efforts toward adjustment made by the members.

Mr. Lim made the following statement:

The paper on financing for countries with payments difficulties presents a broad view of the major developments during the five years that the debt crisis has been upon us. The paper has reminded us that "remedies" and "adaptations" have helped avert the worsening of the crisis but that no lasting solution has yet evolved.

Indeed, if there has been firm agreement on anything, it is that the debt problems can only be resolved over a long period. Even the paper's view on the root of the problem, i.e., excessive borrowing, can be challenged as one sided. We have argued in the past that commercial banks' overexposure, or "excessive lending" at the time of petrodollar recycling contributed as much to the problem. There is ample evidence to show that banks at times conveniently ignored the viability aspect of projects that they financed. Indeed, this may have been the moral basis for debtors' clamor for an "equitable" sharing of the burden of adjustment.

The major participants in the debt strategy have no doubt recognized the importance of a collaborative approach. The emphasis on growth in adjustment models, the menu approach, the changes in regulatory frameworks, and the recognition of the category of poorest debtors for which concessional financing is the only option represent significant improvements over the attitudes and practices during the initial years of the debt crisis when there was resistance to concessions either because innovative solutions "departed from conventional practice," or "would set an undersirable precedent."

Unfortunately, however, considerable uncertainty regarding the availability of financing for development remains, and the environment that would allow countries capable of growing out of their debt problem through trade has not been set.

Instead, as the paper on international capital markets has indicated, countries with debt-servicing problems made net repayments of $10 billion. In addition, private lenders indicated their intention to press forcefully for actions by debtor and creditor governments that would minimize their own exposure increase.

The paper on officially supported export credits reminds us that export credit agencies are not intended to be development finance agencies but are required to facilitate national exports on a commercial basis. It is therefore not surprising that their attitudes will be governed by the risk of nonpayment and resulting claims, and that debtor countries with difficulties are perceived as high-risk countries.

Among creditor governments, progress has been made in changing the regulatory framework to allow more flexibility for private lenders. There may also have been increasing awareness of the need for concessional financing for the poorest debtors.

Progress has occurred in strengthening the financial system, as the papers on capital markets have indicated. At the same time, however, there appears to have been a rise in trade protectionism. We agree with those who express concern that divergence between liberalization of goods and capital markets, and the persistence of the present pattern of global capital flows, could impair the long-run growth and stability of the system.

In the meantime, debtor countries, finding themselves having to sustain adjustment efforts without the needed financial support, have begun to resort to unilateral actions, only to face more isolation.

We agree that the fundamental basis of a debt strategy is the pursuit of effective adjustment policies within the framework of a growth-oriented strategy in the developing countries themselves. We believe that this has been demonstrated by developments in recent years. Equally important, however, is the maintenance of a favorable external environment, namely, sustained noninflationary growth in industrial countries, more liberal trading arrangements, and stable prices and low interest rates. At the same time, we also agree that provision of adequate financing on realistic terms for growth-oriented adjustment strategies is crucial.

What appears to be essential is a leadership that can muster consensus among the international community for a well-coordinated adjustment process. We hope to see the Fund play a central role in this process, particularly in providing additional financial resources. In this regard, we welcome efforts toward a strengthening of the financial position of the Fund, including a sizable quota increase in the very near future.

Mr. Foot, focusing his remarks on the five questions posed in the main staff papers, considered, first, that a more generalized approach to debt was not desirable, with one important and limited exception. The diversity of individual debtors made it impossible in practice to design a general package for all parties' needs, and it therefore followed that all the major participants--including the Fund--should continue to follow the case-by-case approach. It must of course be recognized that the innovations introduced or concessions granted in any one case were likely to be sought in another; and if the case-by-case approach was to work, such concessions must not always be made.

His authorities continued to reject any idea of using official funds to effectively bail out commercial banks for past errors of judgment, Mr. Foot continued. Negotiations concerning relief from bank debt must remain between debtors and banks, the latter continuing to operate within an appropriate tax and regulatory framework. That was not to say, of course, that more should not be done to harmonize the tax and regulatory framework. His authorities had been in the vanguard of such attempts and hoped, like Mr. Grosche, that the progress of the past year could be maintained.

One of the encouraging features in recent months had been the growing recognition that, for a number of countries--particularly the poorest--the answer to current problems was not to pile debt upon debt, Mr. Foot commented. That was the limited exception he had mentioned earlier in his remarks and was at the heart of the proposals put forward by the Chancellor of the Exchequer at the April Interim Committee meeting aimed at giving relief--particularly in the form of interest relief on Paris Club debt--to the poorest countries, which were attempting to make a success of their adjustment programs so that sustained improvements in living standards could be achieved. The initiative toward such interest relief was, in his view, complementary to and as necessary as the enhancement of the structural adjustment facility, and he was disappointed that there had not thus far been a great willingness among many creditor governments to accept the logic of the initiative, namely, that interest rates higher than the maximum likely rate of growth of the economy would never allow countries to escape from mounting debt and from adjustment programs that were doomed to fail because of the pace at which debt piled up. It was his expectation that Chancellor Lawson would return to that subject at the forthcoming Interim Committee meetings.

On the scope for expanding the menu approach, Mr. Foot said that he would advise some caution. Certainly if banks and debtors could agree among themselves, scope for an extension of the menu existed. One recent innovation that had proved successful in the case of Argentina had been the offering of financial incentives to the banks for early participation. Other, more far-reaching, additions to the menu--such as the possible subordination of old debt and securitization--would no doubt continue to be given close attention by negotiators on both sides. In his view, however, certain of the instruments--particularly exit bonds--were unlikely to be a particularly significant addition to any menu, at least until the pricing more closely reflected the views of both sides in the debt negotiations.

So far as vulnerability to external shocks was concerned, his authorities agreed that there was as yet limited opportunity for borrowers to hedge interest rate risk on existing borrowing by using market instruments, Mr. Foot continued. However, the market was an innovative one and, given the mutual willingness of debtors and private creditors to innovate, additions to the menu, such as commodity indexed bonds, could play a key role in some cases.

With regard to the role of official funding, his authorities welcomed the increased flexibility being shown by many export credit agencies and noted that, while new cover had fallen below some expectations, the successful implementation of adjustment schemes, together with that flexibility, would bring increasing amounts of finance from those agencies, Mr. Foot said. In the meantime, he strongly endorsed the staff's views on the danger of developing countries becoming too reliant on short-term export credit cover for goods that would normally have obtained medium-term financing. He could also endorse the view that lending by multilateral development banks, conditional upon policy reforms, would be an important element in resolving the debt problems. However, he could not agree that official creditors should step into the gaps left by the banks, for such action could encourage further bank disengagement. The financial involvement of the Fund and World Bank must be limited to realistic amounts. In that connection, while the Fund might wish to consider approving a temporary buildup of arrears where creditors were seeking to develop innovative arrangements, the institution could not ignore the need for prudence in its lending and must choose the cases for and timing of its intermediation with care.

Mr. Salehkhou made the following statement:

Despite the importance of the subject and the bulk of the excellent set of papers before us, I feel comfortable being relatively brief in my remarks, as I am fairly convinced that the staff has now almost fully recognized the validity of the arguments and projections that this chair, along with those representing other developing countries, has consistently put forth on similar occasions during the past two years. Indeed, in the circumstances, I would have had little difficulty presenting my last year's statement at today's meeting with little or no revision or modifications. However, I will have to present at the end of my intervention the text of a communication from my Algerian authorities in reaction to the references to their country in SM/87/195.

Despite "rosy" scenarios presented and often revamped over time by some of my industrial country colleagues, I remained unconvinced by the validity of the assumptions underlying such scenarios. For example, it is now abundantly clear that the policies pursued or encouraged by industrial countries during recent years on debt issues have been at odds with the principal objectives put forth by this group of countries. In this regard, I recall, inter alia, a lack of effective coordination in economic policies among industrial countries, extreme volatility of exchange and interest rates, historically record low commodity prices, rising protectionism against developing country exports, sharp reductions in credit (both official and private) to developing countries, and an intolerable debt service burden. To make matters worse, the Fund--which was to play the central role in the *so-called debt strategy--has been forced to reduce its exposure* and at the same time sharply increase its conditionality. The question of allocation of SDRs remains only a question, and, given the preliminary indications by some industrial country Directors, the Ninth General Review of Quotas seems to be heading in the same direction as the SDR allocation.

It is disappointing that the world economic outlook remains grim and is indeed worsening, especially as far as LDCs are concerned. Although this will be the topic for our forthcoming discussion on the subject, suffice it to say that the staff has concluded that there is no relief in sight. The reality of the debt problem is such that despite strong and sustained adjustment efforts by LDCs there has been no noticeable return to spontaneous lending by commercial creditors. As regards concerted lending, only those few debtors whose large size of debt could potentially threaten the stability of the international monetary system were beneficiaries, and, even then, only after long delays and some "arm twisting" by major industrial country governments and by heads of the international financial institutions. The staff, on the other hand, candidly reveals, on page 8 of SM/87/190 that "creditors have tended to receive the lion's share of the adjustment dividend." The variety of initiatives and strategies so far has resulted in sizable gains only for commercial concerns and other creditors without offering any lasting solution to the plight of debtors. Debt reschedulings and restructurings, debt/equity swaps, the menu approach, and other imaginative schemes have at best postponed the problem. Should this trend continue, I believe that an increasing number of debtor countries will be forced back off from accepting the type of austerity-oriented adjustment programs which continue to put a disproportionate burden on their shoulders, as recently evidenced by the decisions on the part of some debtors.

I shall refrain from further discussion of past events so as to avoid the risk of repetition or of revealing the obvious. I hope, however, that the necessary conclusions will be reached by all players. We are facing a situation in which a concerted approach is warranted. If we can all agree that the present strategy has not worked as intended, it would be clear that trying more of the same will not result in any change. All suggestions and ideas which are floating around might somewhat alleviate the problem, but, as the staff implicitly recognizes, these ideas will have only a very limited impact. It seems to me that the choice between the case-by-case approach (which is perceived by creditors as the only effective approach) and a more comprehensive one is no longer relevant. The actions are more important than the framework in which they are taken.

In this vein, let me offer some suggestions intended to make a positive contribution to our discussions. I hope that the staff will take note of at least some of them in preparing the forthcoming papers on the subject.

First, it appears to me that a massive and concerted effort at recycling the huge terms of trade gains by industrial countries should be undertaken under the leadership of an appropriate international organization. These gains in 1986 alone amounted to no less than $118 billion. I wonder why and how recycling of the cheap oil and other commodity dollars of the 1980s would be any different from that of petrodollars of the 1970s in their effects on growth and the debt situation.

Second, given its strong liquidity position, and in order to give the right signal to the international financial community, the Fund should step up its lending activity and actively promote feasible and truly growth-oriented adjustment programs acceptable to the borrowing members. To do so, the Fund should be allowed to accelerate its Ninth General Review of Quotas and implement a less restrictive access policy, including access to the special facilities. The Fund should also revive the extended Fund facility so as to effectively support more structural reforms and ameliorate the debt profile of debtor members. These actions are essential if the Fund is to exercise some kind of leverage over the other players in the debt problem. While the staff papers do report that commercial banks have already made that point, they are silent on the position of the World Bank and other creditors, who are also complaining about the net repurchases to the Fund for the second year in a row. This stepping up of the activities of the Fund would of course be helped by a sizable allocation of SDRs.

Third, the World Bank and other international, multilateral, or regional financial institutions should also be encouraged to increase their lending activities, especially toward supporting the structural reforms that they recommend. Some of these reforms, like trade liberalization and tax reforms, have generally some initial adverse impact, which calls for greater financial support than previously thought.

Fourth, commercial banks should be brought back into the picture whenever debtor countries agree to undertake growth-oriented adjustment programs. Monetary authorities in industrial countries, the Fund, and the World Bank should jointly use all the means available to them to ensure such a move by commercial banks. As I mentioned earlier, this would clearly be helped by the leverage the international financial institutions would gain by stepping up their own lending activities.

Fifth, industrial countries should strive to raise ODA to the targeted level of 0.7 percent of their GDP. This, along with increased export credit cover, would go a long way toward helping their exports to LDCs and, in turn, toward promoting investment and growth in these countries, thereby contributing to an improvement in the world economy.

Last but not least, the plight of the members eligible for support from the structural adjustment facility deserves special attention. The initiative of the Managing Director aimed at tripling the facility's resources is a welcome step and it is to be hoped that it could be implemented in a timely fashion. However, I am afraid that the amount of the increase will not be nearly sufficient to put these countries on a growth path. It is therefore necessary that some additional steps be contemplated, including debt forgiveness or at least the granting of highly concessional terms.

These suggestions are by no means exhaustive, as I have limited myself to only financial aspects in line with today's agenda. It goes without saying that any lasting solution should also address such important issues as commodity prices, trade protectionism, and the like. The suggestions I have presented, however, should be part of any lasting solution to the debt problem. Such a solution would result from a revival of the world economy and world trade and not from purely financial gimmicks. An essential ingredient in the success of these actions is the political will of the industrial countries to better coordinate their economies so as to fully utilize their growth potential on a sustainable basis. This political will has yet to materialize. There is indeed an agreement to establish economic and financial indicators to be monitored by the Fund. Studies and discussions on the subject could unnecessarily drag on for a long time; however, the problems are all too well known and could be dealt with by the staff either on the occasion of Article IV consultations with the concerned countries or in the world economic outlook exercise.

Finally, let me state my conviction that if we do not follow such a comprehensive and cooperative approach, an increasing number of debtor countries will find it politically difficult, and perhaps impossible, to continue to implement unpopular adjustment measures without assurances regarding the necessary financial support. Such an attitude would have dire consequences for world trade and the global economy. I hope that this institution under its current able leadership will not let that happen.

Before presenting the text of the Algerian communication, I wish to make a personal comment:

I am of the opinion that the staff should have treated the Algerian case in the same manner, and with the same degree of fairness, as it has the other case studies in Appendix II of SM/87/195. The staff could have, for example, highlighted the courageous and persistent efforts of my authorities in fulfilling their financial obligations to all creditors in spite of the sharp fall in their export receipts following the sizable decline in oil prices; all the more so, as Algeria has managed to avoid recourse to any exceptional financing arrangements.

The text of the communication from my Algerian authorities reads as follows:

> Noteworthy among the conclusions on Algeria set forth in the Fund document entitled "Officially Supported Exports Credits - Developments and Prospects" is the following statement:
>
> 1. "Algeria ranks second, after Brazil, in the total exposure of the export credit agencies."

We wish to request that the Fund staff clarify the nature of this exposure. As we see it, what is important to properly assessing such a situation is the outstanding balance, i.e., credits which have actually been mobilized and have yet to be repaid.

In this regard, we wish to stipulate that Algeria has, within the framework of balanced external trade with its major trading partners and with a view to ensuring the adequate financing of trade, had recourse on a widespread basis to the opening of credit lines with both export credit agencies and the commercial banks of its major supplier countries.

The aim of this procedure is to match up import operations to be carried out with financing arrangements already lined up, thereby avoiding any of the financing pressures that would grow out of recourse to financing on a case-by-case basis owing to the sizable number of operations and many parties involved.

It would appear that the Fund staff treated these credit lines as actual commitments; this is not the case, in that they are used only in stages, and sometimes not at all, even though they remain available.

This can be confirmed by the export credit agencies and commercial banks of Algeria's major trading partners. By way of example, in May, COFACE approved financing in the amount of F 3 billion, but there have yet to be any import operations carried out under that facility. The ECGD has approved a credit line in the amount of F 250 million, which also has yet to be utilized. In addition, all the Algerian banks have had, and continue to benefit from, credit lines with their correspondents in Algeria's major trading partner countries. These lines constitute simple authorizations for the charging of commercial contracts at the time they are concluded.

The document further reads that,

2. "...and to some extent through delays in scheduled debt service payments."

We consider this comment to be unjustified, in that to our knowledge there have been no delays in debt service proper. The export credit agencies that have been in touch with us in this regard have recognized, after considering the explanations provided, that the delays were not in debt payments but instead involved delays in the trade operations themselves, most of which involve legal disputes.

Some delays are also attributable to the fact that foreign suppliers failed to report claims on time to their Algerian debtors.

Finally, the export credit agencies were informed of the new provisions introduced by the Algerian authorities following the sharp drop in oil prices and the cutback in the general import program.

These provisions consisted of the establishment of a disbursement schedule, the introduction and implementation of which resulted in several delays attributable to what the Fund staff calls administrative procedures; these involve trade operations only.

These delays, which began to appear in late FY 1986, have been gradually absorbed during 1987, and the export credit agencies have been kept fully informed. They should be in a position to provide Fund staff with more recent statements (at end-August, for example) that would confirm that the delays previously recorded have been eliminated. To our knowledge, apart from the situations involving legal disputes referred to earlier, there are no delays on record now which exceed normal lengths.

3. The document also mentions that half of the export credit agencies find it unusual that Algeria requests "longer than normal terms for imports normally financed on a short-term basis. Based on previous experience with other countries, many agencies considered these requests as a 'warning light' of payments difficulties."

In this regard, Algeria has never hidden the fact, of which the Fund staff is fully aware, that under current circumstances it was necessary, in order to maintain the pace of economic development and to ensure the regular repayment of the external debt, to make the repayment term of the new credits to be obtained as long as possible. This is why the export financing agencies were asked for longer terms.

In view of the volume and value of our imports, and in light of the competition engaged in by supplier countries, we consider it legitimate to obtain the best possible rates and repayment terms. This effort is part and parcel of the proper management of Algeria's overall debt and not the reflection of financial difficulties, as the Fund staff would appear to be asserting on the basis of the observations of certain export financing agencies, which are naturally disinclined to provide credit on better terms even as they seek simultaneously to promote increases in their respective countries' exports.

4. Algeria is one of the few countries that is continuing scrupulously to meet all its commitments to its creditors. Any appraisal of its relations with its partners must be phrased precisely to ensure the proper identification of the source for the information being communicated.

In this regard, it would have been more enlightening, both for Algeria and for the Executive Board, had the staff indicated the amounts of debt repayment arrears owed to COFACE, HERMES, ECGD, SACE, Du Croire, etc.

Brief analyses based on information that is either outdated or poorly substantiated can harm the Algerian economy in its relations with its partners, disrupting relations which have heretofore been marked by trust and calm.

5. In view of the importance to any document prepared by the Fund staff, we consider it necessary for the staff to show caution and moderation, as well as to be nuanced, in the way it reports information on a subject as delicate as the debt.

In any event, we think that inappropriate references or comparisons that threaten to give rise to tendentious and harmful interpretations should be avoided, in particular when they are not in their proper context.

In conclusion, and in light of the foregoing, we request that the Fund staff revise the section of the document relating to Algeria, clarifying the nature of the concepts used, updating the figures used in the analysis, and presenting its assessments with greater nuance.

On proposed publication of documents in the World Economic and Financial Survey Series, after revisions to reflect Executive Directors' comments, I would like to request, on behalf of my Algerian authorities, that all references to Algeria be deleted. Should those deletions not be possible in their entirety for comprehensiveness or whatever other legitimate reasons, then I would like the staff to consult with my authorities well in advance of the date of publication, in order to leave sufficient time for their careful review of such sensitive material to be included in the proposed publication. I feel that prior consultations would have done more justice to Algeria and other countries which are referred to as case studies and would have provided a check on the information provided to them by outside entities. This would also have assured a balanced and fair presentation of those cases.

Mr. Dai made the following statement:

One of the most prominent features of the current capital market activities can perhaps be described as an increasing polarization. At one extreme, financial transactions among the industrial countries have reached a record high, and, on the other side, net lending to the developing countries has been virtually suspended. Apparently, the enormous trade imbalances and the associated surge in capital flows among the industrial countries are unsustainable, as is, to an even greater extent, the suspension of net lending to the developing countries. The latent unsustainability of the present pattern of global capital flows is certainly worth our reflection.

The recent rapid liberalization, innovation, and growth in the capital markets have increased significantly the capital mobility that tends to enhance the efficient allocation of savings. In reality, however, the underlying macroeconomic imbalances in the major industrial countries have to some degree led to a considerable dislocation of the world's savings. On the one hand, savings are absorbed by excessive government spending in the United States and this, in turn, has led to enormous trade imbalances among the major trading nations. And, of course, it is these huge trade imbalances that have brought about the massive capital flows among industrial countries. On the other hand, unfortunately, at a time when developing countries--and particularly the debtor ones--are pursuing vigorously growth-oriented adjustment, the required financing has come to a standstill and, even worse, negative flow has occurred. The sluggishness of growth in the world economy and trade is obviously the fundamental cause underlying the financial difficulties facing the developing countries. Again, this is mainly owing to the weak economic policies and management of the major industrial countries.

We have recognized that the wide swing in capital markets during the last decade has reflected a response to macroeconomic developments in the major industrial countries, and the present situation continues to indicate that capital market performance depends crucially on economic policy setting of the major industrial countries. Under present circumstances, a sustained rate of growth in output and trade, reductions in interest rates, a stable pattern of exchange rates, a rollback of protectionism in the major industrial countries, and substantial recycling of funds from industrial countries to developing countries should be considered essential in order to return to a normal and enhanced operation of the capital market so that potential instability in the system can be eliminated.

Among recent adaptations in assembling financing packages, the development of new money options to ease the debt-servicing burden of the debtor countries can be seen as a step in the right direction, and further development of new approaches is to be encouraged. Since these new approaches are mostly initiated by creditors and are tailored to satisfy their business interests, they should be carried out with caution in order to avoid any undesirable side effects harmful to the economies of the debtor countries. Moreover, we need to be very much aware of the fact that these approaches, while helpful, are by no means a long-term solution to the debt problem, and that it is not realistic to expect that access to a wide range of options will inspire some great and instant inflow of new money for the debtor countries.

In fact, the fundamental solution to the debt problem lies in the economic growth of debtor countries. It is obvious that debtor countries will be able to generate sufficient resources to repay their debts only if they have adequate growth. As the staff rightly points out in the paper, creditor countries have already received the lion's share of the adjustment dividend from the debtor countries through debt service payments, and they are now in a better position to support growth efforts of debtor countries. We should also not lose sight of the fact that resolution of the debt problem will improve greatly the trade balances of the industrial countries because the developing world has long been an important market for them. Therefore, there is every reason for the industrial countries to provide crucial support to the debtor countries by rolling back protectionism and by following sound economic policies. In addition, the industrial countries should facilitate financial flows to debtor countries through adequate official export credits and through increased official development assistance. For the low-income debtor countries, concessional flows are urgently called for.

I would like to reiterate that one of the root causes of the debt problem is the poor risk management by the commercial banks over the past decade. It is now in their own best interests to participate actively in financing debtors' adjustment programs, which will not only give the economies of the debtor nations a chance to grow but will also improve the financial position of the banks themselves.

Certainly the Fund must continue to play a central role in rectifying the debt problem. In this regard, great importance should be attached to the promotion of policy coordination among the major industrial countries in order that a favorable environment in the world economy can be fostered to facilitate continuous growth-oriented adjustment in the debtor countries. Another major area where the Fund can make a significant contribution is improvement in the design of economic programs, so that adjustment may be implemented more effectively. I would like to stress here that the recommendations put forward by the Deputies of the G-24 on this issue merit serious consideration. More important, however, direct financial support by the Fund needs to be greatly strengthened. For this reason, the review of access policy and the Ninth General Review of Quotas should be carried out with a view to enhancing the financial function of the Fund.

On officially supported export credits, I note that, while export credit agencies have been adopting a more open stance on short-term cover, the volume of new medium-term credit and cover commitment has declined sharply over the past two years. In this connection, I am inclined to suggest that some relaxation in the medium-term cover policy may be worth consideration.

Mr. Dallara considered that it was important to recognize the progress that had been achieved in dealing with the debt problem in the past five years under both the initial strategy--which had evolved in a collaborative fashion in 1982--and the strengthened strategy with its heightened emphasis on growth. As he saw it, there could be only one real test for the debt strategy, namely, to see whether through policy changes and financing, the strategy enhanced prospects for sustainable growth with viable payments positions in debtor countries while preserving international financial stability and expanding world trade. Using the criteria of that test, one must be aware that over the past few years, in spite of the debts and other problems that had emerged, policies had been changed, and financing had flowed. In the longer term, benefits from those policy changes could in many cases be substantial and lasting, particularly if the changes were sustained.

A look at the far-reaching changes implemented in economies as diverse as those of Ghana and Mexico showed that more had been done than simply tackling the obvious fiscal and financial imbalances, Mr. Dallara continued. Liberalization in areas such as trade and the parastatals was likely to have a lasting effect on the economy, and it was difficult for him to believe that such changes would easily have been politically feasible in the environment of international lending that had existed in the late 1970s. Real GDP growth in 1986 had been on average at its highest level over the past six years for the major debtors, averaging 3.8 percent from the negative growth period of 1983. The ability to service debt, as measured by interest payments over exports, had dropped from 31 percent to 27 percent. And while many would like to see further declines in interest rates, it was clear that interest obligations and existing debt were nearly $20 billion lower at present because of the nominal declines that had developed over the past few years.

It was clear that all creditors and debtors must play their respective roles in the debt strategy, and he fully agreed with Mr. Massé that the ability of the industrial countries to more effectively coordinate their policies in the period ahead would be critical to sustaining adequate levels of global growth and open markets that could provide the broad framework within which debtor countries could make progress, Mr. Dallara remarked. However, he could not accept the continued emphasis on the single issue of the U.S. fiscal deficit. The time had come to recognize that collaborative efforts by the United States and other major countries was the only way to deal with the debt problem. That was not to minimize the impact of the U.S. fiscal deficit but only to indicate that its resolution alone would not resolve the debt problem.

With regard to the relative roles of creditors and debtors, Mr. Dallara mentioned that his colleagues should not delude themselves into believing there could be any significant shift in the relative financial roles of official and private parties. That was not to say that official creditors, both bilaterally and multilaterally, did not continue to have an important role to play; but it would be a mistake to view the World Bank, for example, as a possible substitute for private financing. The Bank must continue to be a catalyst for additional financing if it was to be successful.

Alleviation of debt problems in the debtor nations had been, and would continue to be, the single most important factor in generating appropriate capital inflows, Mr. Dallara commented. In that regard, he looked forward to discussing on other occasions the importance of policy changes, and the Fund's role in those policy changes, in the overall debt strategy. Perhaps such discussions would be possible when the Board looked at the role of the Fund in conjunction with proposals on that matter in the G-10 and G-24 reports. In general, however, it was clear that the Fund had played and would need to continue to play a central role in the debt strategy. That role was fundamentally based on the institution's ability to serve as a catalyst for sound policies and external financial support through the provision of balanced and sensible policy advice. The Fund's credibility in that respect would seem to turn up the perception in the broader international community that the Fund could recognize both appropriate and inappropriate policies and that it was willing to encourage, and associate itself with, the former and discourage, and disassociate itself from, the latter. In that connection, perhaps one of the more disappointing aspects of the Fund's role in the debt strategy in recent years had been enhanced surveillance, and it was to be hoped that the Fund would return to that issue as well in the period ahead.

The Fund's financial role was also important and must be flexibly maintained consistent with the Fund's character as a temporary source of balance of payments financing, Mr. Dallara remarked. In that respect, the Managing Director's initiative to finance the strucutral adjustment facility seemed to be appropriately directed toward finding a proper balance between facilitating the continuation of a central role for the Fund in the debt strategy while respecting some essential elements of the character of the institution.

On the questions raised in the main staff paper, Mr. Dallara said that he fully agreed with the staff that a generalized approach was not the answer to the debt problem. Indeed, recent developments clearly underscored the importance of a diversified, case-by-case approach. It was of course important in the circumstances that both creditors and debtors be willing to look at the merits of individual cases, a point to

Mr. Mawakani made the following statement:

From the set of papers that is being discussed today, two main facts for 1986 emerge: first, developing countries obtained no net financing in international bank and bond markets; and, second, there was an acceleration in lending to industrial countries. Both developments are cause for concern. The first indicates that developing countries, and more especially the debtor countries, are not getting adequate funds to support their growth-oriented adjustment programs. The second is a reflection of policies being followed in some industrial countries where deficits are increasing. By virtue of the size and strength of their economies, these industrial countries are attracting scarce resources that could have been made available to developing countries.

I shall briefly comment on each of the topics for discussion today. First, on developments in the international capital markets, we continue to be very concerned at the slowdown in capital flows to developing countries. As the staff paper indicates, in 1986, developing countries as a whole made net repayments to commercial financial institutions. Many of these countries, especially those with severe debt-servicing problems, are pursuing strong growth-oriented adjustment programs that need to be supported with significant financial resources. The inadequate flows of such capital can only adversely affect the success of these programs. For those countries that were able to receive additional capital inflows from commercial banks, I note that there has been in many cases a hardening of the conditions. This is all the more worrisome because such a stance indicates that debtor countries are made to bear an inordinate proportion of the debt burden. Commercial banks are still not carrying their fair share of the debt burden.

I note, however, that some banks have begun to show a greater awareness of the difficult financial position of developing countries and are coming up with a more imaginative approach with respect to the debt problem. While these innovations can give the countries a breathing spell in the immediate future, the burden associated with the servicing of the debt in the longer run is increased. This can lead to severe problems if there is a worsening in the international economic situation.

As it appears from the papers, the prospects for more normal lending are not encouraging. Among the reasons given by bankers is the uncertainty with regard to future developments in interest rates and exchange rate markets. This uncertainty is related to the large imbalances in the internal and external positions of some industrial countries. And until those imbalances are reduced, the availability of financial resources to support the adjustment efforts of the developing countries will continue to be inadequate.

Second, in the paper on financing for countries with payments difficulties, reference is made to the necessity of debtor countries to follow strong adjustment programs in order to restore their creditworthiness. Over the past few years, most of these countries have been implementing adjustment programs with Fund financial support; yet, adequate financing from commercial banks has not been forthcoming. This reinforces my authorities' view that adjustment efforts alone are not sufficient to establish creditworthiness.

Perhaps the most important factor is the prospect for increasing export receipts. While many of these countries have taken strong steps to increase exports, factors beyond their control have adversely affected these efforts. These include low growth in industrial countries, low commodity export prices, and uncertainty in the financial markets. These developments again indicate that a successful adjustment process that can lead to sustainable growth and improve the ability to repay debts depends, to a large extent, on industrial countries' policies. The implementation of appropriate policies in industrial countries is, therefore, also a necessary ingredient in the effort to solve the debt problem.

With regard to new types of financing options, one possibility is for multilateral development banks and other financial institutions to increase the amount of their financial assistance to developing debtor countries and to make that assistance available at highly concessional terms. In that respect, the efforts to triple the amount of structural adjustment facility resources are in the right direction. Furthermore, as the staff mentions, some type of debt relief will need to be considered for many of those countries, especially for those in Africa, since the rescheduling of their debts as is done now through the Paris Club can only postpone the problem.

Third, on the subject of officially supported export credits, I welcome the fact that export credit agencies have been adopting a more positive stance. But I cannot fail to notice that the volume of new market credit and cover commitments to developing countries has continued to fall over the last two years. One reason given is that many countries with payments problems have reduced the number of investment projects. While in certain measure this may indicate an effort at improving efficiency, it also indicates that the efforts to reduce imbalances are being made at the expense of investment, because external financing has been inadequate. Continued reduction in the investment budget can only lead to a lowering of future economic growth with all its adverse consequences. I would therefore urge the authorities in those countries to adopt a more flexible approach with respect to export credit.

Finally, on the inadequacies in presently available statistics on officially supported export credits, I support the staff's call for governments to cooperate fully with the OECD and the Berne Union in their initiatives to improve these statistics.

Mr. Chatah made the following statement:

In March 1987, we in the Board had an opportunity to express our views on the various issues relating to the debt problem and the current strategy to deal with it; to a large extent, the comments we made on that occasion continue to apply today. I will therefore limit myself to a few remarks on recent developments and on some of the questions which are raised in the staff documents.

An important underlying factor in the recent experience with the debt situation seems to be the increased and more explicit recognition, by all parties involved, that the debt problem will take a relatively long time to be resolved. This recognition appears to have been a major motivating factor behind some of the recent adaptations in the process of restructuring and concerted lending by commercial banks. To that extent, it has been a positive development. On the other hand, it can also be said that the increased recognition of the long-term nature of the problem was itself a major reason for the increased reluctance of banks to participate in financial packages which, in turn, made those adaptations necessary. One can also argue that the receding horizon for a solution to the debt problem has made it more difficult to obtain the much needed political support for the sustained and lengthy adjustment process which debtor countries have to underake. Thus, while more realism on the part of both debtors and commercial banks is a healthy development in principle, it does represent a challenge to the current debt strategy. The question of apportioning the dividends of adjustment between debtors and creditors has clearly become more urgent, particularly in light of the feeling among debtor countries that those dividends have, for the most part, accrued to commercial banks. The implications of such a perception for the sustainability of, and public support for, adjustment are obvious. The difficulty of improving the manner in which adjustment benefits are shared is, of course, compounded by an increasingly reluctant attitude on the part of commercial banks.

The debt strategy will also have to cope with a global economic environment which has not been conducive to the type of export-oriented and growth-oriented adjustment by debtor countries that constitutes an essential element of the current strategy. The unfavorable external environment facing these countries and the uncertain outlook for the world economy have not only impeded the adjustment-through-growth objective but have apparently been a significant factor in the perception of banks concerning the sustainability of adjustment in debtor countries. While, admittedly, the global economic environment is shaped by a complex set of factors and policies, which are motivated by a wide range of considerations and objectives, there can be little doubt that macroeconomic and trade policies of major industrial countries play a crucial role in shaping the external environment facing debtor countries. This in turn highlights the crucial importance of reinforcing, and translating into action, the growing recognition in major industrial countries of the important role which their policies play in the evolution of the debt situation. This is particularly so in the area of protectionism and market access.

Although the systemic threat of the debt problem is still considerable, as the staff indicates, the fact remains that the reduced level of that threat and the strengthened position of commercial banks over the recent period, have had a negative impact on banks' willingness to participate in financial packages and to maintain, much less increase, their exposure to the heavily indebted countries. The improved position of banks has also been a factor behind the even stronger reluctance to participate in new money packages for what the staff describes as "nonsystem countries." Although as a matter of principle one can understand the banks' preference for engaging in project and trade financing as opposed to general purpose lending, these are obviously not normal times, and banks' involvement in balance of payments financing will continue to be essential in the forseeable future. Incidentally, like Mr. Ortiz, I noted the fact mentioned by the staff that banks have been pressing for greater involvement in the distribution of financing gaps, presumably in an effort to reduce their exposure. I have also noted, however, the staff's statement that "more experienced" bank officials are more accommodating on this issue. One would like to think that more experienced bankers are also wiser. An alternative explanation, which I personally find more interesting, might be that bankers who are more experienced are also more likely to have been involved in the decision to extend those loans in the first place.

As far as the low-income indebted countries are concerned, it has become clear to all that, given their exceptional situation, exceptional treatments are unavoidable. We have noted that the Paris Club has already relaxed some of its rescheduling terms for a number of such countries. Clearly, however, more needs to be done. For example, as the staff indicates, official debt originally contracted on commercial terms has generally been rescheduled on commercial terms. Given the debt-servicing outlook of this group of countries, such rescheduling terms are clearly unrealistic and only add to the sense of fatalism in these countries about their chances of ever being able to normalize their external payments positions.

Obviously, there is more to be said on the question of the debt of low-income countries, and we will have a chance to discuss this issue in the future. Let me just add here that, in our view, multilateral institutions, including the Fund through the structural adjustment facility, have a particularly crucial role to play in assisting the low-income countries whose need for generous concessional finance as opposed to commercial finance, at least for the forseeable future, is quite obvious.

On officially supported export credits, like others, we welcome the apparent increase in flexibility of export credit and cover policies. I note, however, that not only have new commitments been declining, but offers by export credit agencies have recently been declining at a faster rate than new commitments. This suggests that new commitments are likely to continue to decline at least in the near future. Another source of concern is the recent increase in the share of certain agencies' short-term commitments in their total business, a development that has obvious implications for the maturity structure of the external debt of developing countries. Furthermore, some of these countries--which would normally have obtained medium-term financing--have been seeking short-term credit to finance imports, which underscores the difficulties experienced by these countries and, as the staff observes, reflects greater restrictiveness of agencies' policies vis-à-vis medium-term cover.

It would be presumptuous of me to suggest specifically whether and how the current debt strategy should be reoriented to take into account the present circumstances and likely developments in the global economy as well as the changing attitudes on the part of debtors and creditors. Obviously, any such reorientation will have to be the result of serious and pragmatic discussions among all the parties involved. Some would even say that the evolution of the debt situation may have reached the point where its course is likely to be determined more by spontaneous forces than by any deliberate effort to redirect that course. In any event, we tend to share the staff's view that a generalized approach to the debt problem is not feasible. On the other hand, the concerted case-by-case approach provides only a framework to deal with the problem and not a solution as such. The success of this approach depends on a number of crucial factors or assumptions, at least two of which--namely, a conducive external environment and adequate bank financing--have been lacking. As I said earlier, the adaptations to commercial bank participation, including the menu approach to encourage such participation, are welcome. Although I agree with Mr. Dallara's comment that some of these alternative mechanisms can gain importance over time, I agree with the view that the overall significance of these adaptations could be exaggerated. They are certainly not a panacea. Indeed, the complexity of the debt problem precludes simple solutions. One can only hope that the deliberations during the Annual Meetings and the ongoing discussions with commercial banks will contribute to the formulation of a common understanding of what needs to be done and what can be done in the critical period that lies ahead.

Mr. Ovi made the following statement:

There is no doubt that resolving the prevailing debt problems will take considerably longer than earlier anticipated. Solutions will have to be based on a coherent long-term strategy in the form of growth-oriented adjustment programs financially backed by the international community on realistic terms. However, because of large intercountry differences, the debt problems still need to be handled on the traditional case-by-case basis. The ultimate objective for the debtor countries should be to regain access to the international capital markets on normal terms. This implies that all parties must contribute to resolving the debt problem. Recently, it has become more apparent that not all of them have done so in a manner sufficient to ensure the smooth implementation of the debt strategy.

The debtors, both Baker plan countries and low-income countries, should, in the first place, create conditions for resolving their debt and structural problems through the necessary adjustment. The industrial countries, for their part, should create conditions for the needed economic growth and should resist protectionism in order to provide a favorable external environment for the debtor countries.

It is in the interests of the private banks themselves to shoulder their share in solving the debt problem. Therefore, it is welcome that the banks have increasingly--by means of larger own capital and loan-loss provisions--become less vulnerable, and are now better equipped to meet the demands of debtor countries. Against this background, it is especially regrettable that debt-distressed countries in 1986 had to make net repayments on this outstanding stock of debt to banks.

The roles of the Fund, the World Bank and regional development banks as catalysts have to be preserved. This calls for increased financial aid, both from international development banks and from bilateral donors. In this connection, a substantial capital increase for the World Bank will be of major importance. Also, the catalytic role of the Fund may imply a growing use of Fund resources in the coming period.

At the same time, I find it important that the Fund preserve its independent status in the negotiations with the debtor countries. This chair is against more extensive use of the instrument of enhanced surveillance. To the extent that it is used, it should be limited to rather short periods, and conditions should be decided on by the Fund Board without the interference of private banks.

Turning specifically to the documents before us, I find that in countries where adjustment has facilitated regular debt service, creditors have, as suggested by the staff, tended to receive a major share of the adjustment dividend. At the same time, in the debt-distressed developing countries, creditors have also de facto suffered considerable losses.

As a supplement to the present financing models, a number of alternative ones have been produced recently that can make a contribution--even if a modest one--to resolving the debt problem. These comprise innovations with regard to bank loans as well as initiatives taken by the Fund and the Paris Club. Even though these innovations present a wide range of new options for the solution of the debt problem, the main emphasis in the formulation of the debt strategy will continue to be on the present conditional adjustment and financing programs. Still, these innovations should be evaluated as particularly welcome insofar as they contribute to increasing incentives for private banks to participate in solving the debt problems, while at the same time making it more feasible for debtor countries to meet their obligations.

The banks have expressed a clear preference for restricting their lending as far as possible to specific projects or to exports. At the same time, they seek increased cofinancing with the multilateral development banks. This may be a way to create more bank lending, but given the present situation, there should be a more general involvement of the banks in the resolution of the debt problem. This applies also to the case of the smaller, middle-income debtor countries, which seem increasingly to be forgotten by the banks.

This chair considers it important that special initiatives be launched to alleviate the debt burden of the low-income countries. These initiatives should be based on concessional funds, and further debt accumulation on commercial terms should be avoided. Also, actual debt forgiveness should be considered for the low-income countries. A significant contribution should be made by countries with a low level of ODA transfers. In addition, increased lending by the multilateral development banks is needed. We welcome the initiative to enlarge the structural adjustment facility and find the action program within the framework of the IBRD to be valuable.

Paris Club agreements may also play an increasingly important role in these countries. We endorse the lengthening of grace and reimbursement periods granted for the most heavily indebted low-income countries in recent Paris Club reschedulings. With regard to interest concessions, I look forward to the further deliberations in the Paris Club. Some countries in my constituency have, in the present situation, expressed a positive attitude toward interest rate concessions for the poorest countries.

Finally, my authorities support the continued central role for the Fund in the debt strategy. However, it is of great importance that the Fund's financial support always be conditional and based on a serious and profound adjustment strategy adapted to the situation of the country concerned.

Officially supported export credits are generally provided in accordance with international agreements. In individual cases, the credits should, as a rule, be based on an assessment of risk. Guarantees and credit granting should be restricted to financing of exports and should not provide general balance of payments financing. The activities of the export credit institutions should be self-supporting over time.

My constituency endorses the export credit agencies' moves since 1985 toward more flexible practices in cover policies. The agencies have proceeded to a more rapid reopening of cover as debtor countries have embarked on an adjustment path. It is also a positive feature that the agencies are more carefully assessing the development of countries' creditworthiness; but, despite improved monitoring, there is still a tendency for export credit agencies to be too late in tightening the granting of credit to countries where payments problems can be foreseen. This has often led to an exacerbation of the problems.

Debtor countries should themselves enhance their chances of obtaining export credits by enabling foreign creditors to acquire adequate security and legal protection for the credits. My chair supports the idea of finding solutions to this problem, for instance, with the support of technical assistance from the IFC.

Furthermore, it is of primary importance that debtor countries promptly service their short-term credits and that the cut-off dates be maintained in the necessary reschedulings. A more target-oriented recovery policy, with the objective of promoting investments, could clear the way for a renewed rise in export credits to debtor countries.

Finally, my constituency supports the efforts under way in the OECD and in the Berne Union to improve export credit statistics. For its part, the Fund could, through its export credit studies and country analyses, further facilitate the work of the export credit agencies.

Mr. Donoso made the following statement:

It is not clear to me whether the staff papers on capital markets support or contradict the views that are being presented on the same matters in the world economic outlook papers we are going to discuss soon. In the Statistical Appendix of the world economic outlook papers, in Table A42, a summary of external financing for developing countries, grouped according to analytical categories, is presented. According to this table, the 15 heavily indebted countries will have in 1987 a deficit on goods and services and private transfers of $14.5 billion. In addition, these countries will accumulate $5.2 billion in international reserves and another (net) $1.6 billion in foreign assets.

This totals $21.3 billion of financial requirements. If we add to this amount repayments to the Fund, elimination of arrears, and all changes in reserve-related liabilities, the total financing required would be $26.9 billion.

The financing to meet such requirements would come from: (a) direct foreign investment ($4.8 billion); (b) long-term borrowing from offical creditors ($10.7 billion); and (c) other borrowing, including long- and short-term financing from commercial banks, suppliers, and bonds ($11.4 billion).

If the estimates of the staff are correct, the financing from private sources will rise from $0.2 billion in 1986 to $11.4 billion in 1987. This $11.4 billion would of course represent a big departure from what has been observable in this respect in the years after 1982.

If we add the financial contribution of these private sources to the 15 heavily indebted countries from 1983 to 1986, we get a negative figure, minus $0.2 billion. In 1984, the figure reached $3.6 billion. In the other years, the figure was virtually zero or negative. Even the figure for 1984 is only one third of the World Economic Outlook estimates for 1987.

The papers on capital markets present a description of policies and events concerning financing to indebted countries that seems inconsistent with this expectation of $11.4 billion of financing in the World Economic Outlook. From an analysis of the papers on capital markets, one is left with the impression that less money rather than more will be available from private sources in 1987. I wonder whether these figures in the World Economic Outlook papers are consistent with the views expressed in the capital markets paper, or whether they reflect a different approach or a different methodology used for different purposes.

Even if we were to consider no accumulation of international reserves in the indebted countries, we would still require $6.2 billion from private sources in 1987 to finance the current account deficit of the indebted countries, and this figure would still be double the figure registered in 1984. We would appreciate a clarification by the staff on this matter.

Also deserving of comment is the urgency of the need to improve our understanding of the problem in order to analyze better ways of dealing with it in future. Even if the difficulties discussed by the staff remain consistent with the World Economic Outlook figures, the situation will be extremely difficult. I found the paper on officially supported export credits interesting and clarifying in this respect. According to the paper, the lower level of official financing for exports to developing countries is due to the fact that countries are investing less than in the past. There is not so much a lack of financing as a low demand for financing, due to the generally constrained economic situation in developing and indebted countries.

According to the World Economic Outlook papers, imports in the 15 heavily indebted countries will be roughly the same in 1987 as they were in 1983, and GDP per capita will still be some 6 percent below its level in 1980 for these countries. It is obvious that rather than assuring the financing at the levels contemplated in the world economic outlook exercise, we should be trying to increase that financing. The pessimistic analysis presented by the staff is therefore extremely worrisome, and it is particularly important to study ways to assure that the financing required will be forthcoming.

Taking different pieces of information and analysis in the papers, I find that the banks have contributed up to now to the financing of these countries mostly because they have seen no better alternative in the short term. They had to react to avoid more critical circumstances in 1983. Through time, however, the sense of urgency was lost and their cooperation became increasingly difficult to obtain. What appears to have prompted their cooperation in some recent cases has been the simultaneous existence of potentially damaging situations in other countries. Our objective should be to move away from this equilibrium based on fear of the consequences of alternative actions in order to arrive at a more stable system.

In the short term, and so long as no changes are introduced in the present system, it is important that every party involved in the problem perceives the costs of not contributing to the management of the problem. Along this line, the Fund should move to support adjustment efforts of countries with its resources--even if arrears to banks accumulate--when financing from banks is not available on reasonable conditions. We welcome this as a step to strengthen the strategy.

Beyond the short term, our objective should be to better understand the situation and look at the merits of alternative ways of strengthening or modifying the present strategy. We look forward to the analysis of the work in preparation by the staff on these matters, stressing the importance we attach to it. In a sense, the papers for today's discussion contain sufficient information. Many aspects of the problem are described exhaustively and accurately. Still, they do not fully develop an analytical view of the problem which could facilitate our task of defining how the Fund is going to act to mobilize all parties involved toward a better way of dealing with the debt problem.

My concern is that if we do not have a more concrete view of the problem, it will be difficult for us to convince the parties involved in the problem to maintain what others have labeled the central role of the Fund in the strategy. In this connection, we should be very careful not to attach excessive importance to the role of the menu approach in overcoming the present difficulties. As I see it, the approach might play an important role in facilitating things, but only marginally, in the sense that other elements must be present to ensure the participation of the banks.

I note that the staff has considered debt buy-backs, for example, as part of the menu. Of course, if we define the menu approach as one containing any possible tool for dealing with the debt problem, it becomes by definition the complete solution to the problem. I think what the banks have in mind is more limited. Still, as some other Directors have indicated, the menu is presented by the banks as an alternative to general purpose financing. This, of course, could aggravate the present problems.

I would advise keeping the menu under observation until we are able to better define the role it is able to play and until we clarify what we see as the way to reinforce or modify our treatment of the debt problem. I hope that we can move soon from this stage--of simply being open to consideration of potentially useful initiatives--to a more operative phase of dealing with the debt problem.

Mr. Zecchini made the following statement:

Before commenting on some specific points in the voluminous and informative papers prepared by the staff, I think it would be appropriate to offer a few general considerations to pinpoint what we consider major issues of today's discussion. First, it is clear that 1986 has brought to full exposure the peculiar process of debtor country financing that has been taking place since 1982. In the early 1980s, both industrial and developing countries could tap market sources of finance to cover their external imbalances. Since then, developing countries have seen their access to the markets gradually curtailed, and they have become increasingly dependent on both direct official financing and nonspontaneous private loans, which were granted mainly because of official interventions.

In 1986 and early 1987, it has become evident that official or quasi-official institutions in industrial countries have been called to perform the function that in the 1970s was carried out by the U.S. banking system, namely, to recycle excess savings in some economies as well as to boost financing toward the developing countries that are in structural and systemic external deficit. The extremely split conditions of today's markets show that industrial countries are now borrowing to a large extent not only to finance their own imbalances but also to finance LDCs' imbalances. Moreover, public money tends eventually to shield debtor countries as well as the private financial community against the natural consequences of sovereign insolvency or even de facto debt repudiation that takes place when debtors refuse to adjust their economies to a sufficient degree to repay their debts. Two points should be highlighted here: first, is this process of recycling and boosting credit to the LDCs viable over the longer term; and, second, in an ex post assessment of the debt strategy, are we sure that the strategy pursued so far has proved to be better than another strategy where more systemic, well-structured and internationally coordinated interventions of public money would speed up the restoration of LDCs' normal access to financial markets without the strains we have been seeing so far and at a lower cost for the public sector of creditor countries?

I do not intend to debate these issues here now, but the Board and the staff should consider them sooner or later. For those who still have some doubts about the extent of the involvement of public money in this process, I wish to recall that the public sector of major industrial countries has provided financial support to debtor countries not only through direct credits but also in many indirect ways, even through lower tax revenues when banks recorded losses in their loans or by maintaining fiscal and monetary policy stances that are more accommodating than what would be required for domestic reasons.

The second set of considerations pertains to the significant withdrawal of financial support by the U.S. banks to the developing countries. According to the staff, all categories of U.S. banks reduced their claims on developing countries in all regions. In this connection, the first issue is whether this is also the result of the large net debtor position of the United States in recent years. Specifically, can the largest economy in the Western world still perform a vital financing role for the world economy in a period of sizable and persistent deficits in both the current and capital accounts of its balance of payments? By the same token are we sure that the financial systems of large surplus economies can fill the gaps left by the U.S. financial systems? The decline in German banks' claims on developing countries in 1986 is not a good omen. But, more generally, it is questionable whether the regulatory and supervisory environment of these large surplus countries is adequate to support the expanded worldwide role that these banking systems are called upon to perform. Without improvements in these areas, there might be a risk that important private financial systems will take a secondary role in the debt strategy and leave an increasing financial burden on the public sectors of these countries.

The third set of considerations deals with the fact that in 1986-87, capital markets have been absorbing substantial interest and exchange rate as well as financial instrument shocks effectively but not without losses. Financial liberalization and innovation have largely been beneficial in meeting the particular needs of borrowing countries and in providing hedging opportunities. However, they have also entailed increasing risks, as intermediation activity can move more freely within or between national markets in response to the profit opportunities allowed by regulatory and tax treatments. In such a context, are the present national supervision regimes adequate? In our opinion, a more determined effort to harmonize the regulatory regimes is essential to reduce the threat to the stability of the financial system which derives from the possible failure of market participants.

I will next comment on three aspects: (1) financial flows among industrial countries; (2) developments in the debt problem; and (3) export credit.

Financial flows among industrial countries have doubled in 1986, driven by widening external imbalances and financial innovation. The rapid pace of increase gives rise to two major concerns. The first pertains to the sustainability in the long run of such large imbalances and related capital flows. This issue will need to be addressed extensively in the coming World Economic Outlook discussion. The second concern pertains to the effects of financial innovation and liberalization on the stability of financial markets and the international monetary system at large. This issue has macroeconomic and microeconomic aspects.

From the macroeconomic point of view, it is clear, first, that the process of trade liberalization has to keep up with the pace of financial liberalization. If increased international capital mobility is not matched by improvements in the mobility of goods and services, the different speeds to adjustment between the real sectors and the financial ones will result in increasing exchange rate volatility. Paradoxically, in the present times of financial liberalization, protectionist pressures are resurfacing.

Such pressures should be resisted and, in order to improve the overall stability of the system, progress should be made in liberalizing the flow of goods and nonfinancial services.

Second, international economic policy coordination must be strengthened. Global financial markets tend to amplify the adverse effects of inconsistent policies in the major countries. In a world characterized by increasing capital mobility, the degree of autonomy of domestic policies is constrained; hence, increased coordination of domestic policies is required to avoid excessive or disruptive movements of the exchange rates. As we all have come to know, protracted exchange rate misalignments have real effects that are not easy to correct. The Fund's contributions in promoting trade liberalization and policy coordination can be greatly beneficial to the stability of the system at large.

From the microeconomic point of view, two sets of problems should be mentioned. First, more efficient and integrated financial markets do not necessarily bring about immediately a more efficient allocation of resources. It is likely that the changes in the environment can generate tensions in the business world, increase uncertainty, and thus reduce investments and employment. Second, risk assessment in the system may be made more difficult by the process of innovation. The proliferation of intermediaries might loosen the link between lenders and final borrowers. Transparency of the market might be blurred. Disclosure practices might become less effective. Risks might turn out to be underpriced.

Therefore, while we fully appreciate the potential long-term benefits of the innovation process that the financial markets are undergoing, we believe that an enhancement of the supervisory and regulatory activity is required. Improvements should aim both at broadening the authorities' ability to monitor the overall market risk, as distinct from supervising individual bank risks, and at harmonizing regulatory conditions across countries and markets.

The situation with respect to national and international lending to LDCs is still rather bleak. Although between 1985 and 1986 the aggregate current account deficit of these countries has nearly doubled to $48 billion, LDCs repaid a net amount of $2 billion to private creditors. Moreover, in the first six months of 1987, the increase in disbursements under concerted lending packages (which amounted to $3.5 billion--more than in all 1986) was counterbalanced by a considerable reduction in spontaneous lending commitments (to an annualized rate of $12.2 billion, compared with $16.7 billion) and by further shrinking of the access of LDCs to the international bond market.

Table 11 of SM/87/194 indicates that net repayments to banks in 1986 amounted to $3.5 billion for the 15 heavily indebted countries and to $11 billion for countries with debt-servicing problems. These reductions are equivalent to a reduction by 3-4 percent of the stock of debt in 1985.

If continued into 1987, a reduction of bank lending by such absolute and relative amounts risks undermining the overall adjustment strategy pursued so far. In this respect, it should be recalled that according to the recent WEO, in 1987 the current account deficits of the above-mentioned countries will remain stable and the amount of official lending, which remained constant in 1986, is likely to increase, but not enough to cover the financial needs of these countries. Although some reduction of reserves is possible, net external borrowing from private sources must increase significantly to allow the developing economies to expand.

It is on the qualitative side, however, that at least two positive developments must be acknowledged. In fact, the success of the menu approach and the increase in external debt provisioning by some U.S. banks seem to be steps in the right direction, although still too modest to improve the management of the debt crisis.

As for the menu approach, the relatively fast response of the banking community to the financial request of Argentina has shown that there is scope for improvements in the debt strategy purely on the basis of increasing sophistication in financing techniques. Such improvements, however, have to be seen with a good deal of realism, avoiding overstatement of their potential and overall magnitude.

As the staff says, the scope of a number of menu items is in fact limited because of the Government's needs for general purpose borrowing. Onlending, relending, debt equity swaps and so on are project-related forms of financing which could expand slowly due to the uncertain investment environment and the often limited investment opportunities of debtor countries. Moreover, the success of some new products of financial "engineering" is uncertain--as was the case for the Argentine exit bonds--due to the difficulties in pricing them. Therefore, the amount of new resources provided through the menu approach could be modest compared to the borrowing requirements.

We believe that although the most recent financing packages have all the elements for a bolder approach to the debt crisis, additional efforts from commercial banks are necessary to improve the terms of the rescheduling, to reduce the spread on interest rates and to increase the amount of new money provided. Under the present circumstandes, in fact, there remains a real risk of unilateral debt relief or other "nonconventional" initiatives, such as the one recently announced by the Brazilian Government.

As for the banks' recent move to increase provisioning against losses on loans to LDCs, this is not a negative development if it does not lead to rising aversion to lending to LDCs. The rise in the secondary market transactions on these credit claims is also a positive development, since it may contribute to investors' portfolio adjustments and improved willingness to lend. Moreover, debtor countries could have an incentive to enter the market to reduce the size of their debt at a discount. In this context, the room for debt equity swaps could be larger than what we see now.

Some aspects of the implementation of debt equity conversion, however, deserve attention. First, the conversion of debt into equity should not represent a means to subsidize foreign investments that would have been realized anyway, but should ensure real "additionality," as in the Argentina package. In this light, an improvement of the economic environment and an enhancement of the investment opportunities by the host country is necessary to enlarge the room for debt conversion. Here, the role of the World Bank can be crucial. In particular, the establishment by the IFC of equity investment funds in debtor countries should be supported. Second, a cautious management of domestic economic policies is necessary to enhance confidence in the domestic economy and also to minimize the monetary and fiscal impact arising from the debt conversion.

As to export credit financing, I find the staff paper informative and well organized. It is clear from the arguments presented that the 1986 fall in export credit volume was due to the reduction of demand from the importers and not to a constraint related to the supply of credit on the part of industrial countries. The fall in demand in turn has to be attributed mainly to the curtailment of investment projects. We share the staff's concern on the adequacy of the available statistics on export credit. In this respect, we will support, for our part, the efforts presently under way in the OECD and the Berne Union to improve such statistics.

While we welcome the renewed interest in project financing on the part of export credit agencies, we wish to recommend that this financing be undertaken in close cooperation with the multilateral development banks, particularly the World Bank. These institutions, drawing on their extensive expertise, should provide assistance in project selection. In this respect, we would be interested in hearing from the staff whether further steps are envisaged in order to better coordinate the action of export credit agencies with that of multilateral development banks.

The staff representative from the Exchange and Trade Relations Department recalled that several Directors had wondered whether the recent marking to higher risk levels and associated higher provisioning by the banking community did not darken the financing picture. As she saw it, in fact, one could easily argue the opposite. Financing packages, by their nature, involved the provision of debt relief. One could argue about whether such relief was sufficient or whether the modalities were right, but it was clear that both maturity structures and remuneration were more generous toward the borrower than the market normally would have mandated. Also, the banks' more overt recognition of the risk levels involved and their decision to "bite the bullet" and make more adequate provisioning, had removed--rather than added--an impediment to more normal market relations. In any event, the action of the banks underscored the conviction that the approach to the debt problem needed to be eclectic, a note sounded by most speakers during the discussion.

If one accepted the appropriateness of the case-by-case approach, it was clear that one must differentiate between the question whether the need for debt relief was a general factor in all cases, and the question whether the need for debt relief demanded a generalized solution, the staff representative continued. She saw much confusion between those two notions. The Fund would no doubt support solutions that creditors and debtors could agree upon on a case-by-case basis, taking advantage of all the market innovations available. In that respect, it was clearly impossible to adopt or initiate an innovative approach without to some extent creating a "precedent." Her concern was that fear of setting a precedent might make it difficult to take account of special circumstances or to make exceptions in appropriate cases.

She would find it difficult to support a generalized solution to the debt problem of the sort that relied on an international institution buying up the outstanding bank claims at market value, i.e., at a discount, and then turning over to the debtor the difference between the discounted and the face value of the debt. At present, secondary markets for sovereign debt were quite thin, and it was difficult to know in many cases what the market valuation of the debt might be. However, a look at current discounts, and abstracting for the upward pressure on secondary market prices that a buy-back decision would bring about, made it easy to see that, even speaking conservatively, buying up the outstanding debt for those countries for which discounts were quoted would involve some $125 billion, an amount that, for example, exceeded the capitalization of the World Bank. Even if such an approach could be effected, the banks still would have to absorb the losses, as would the taxpayers in the countries in which the banks resided. The result would be mainly to make the banks more liquid, and it was not at all certain that the liquidity generated for the banks would be channeled back to the original debtor countries. In any event, the need for an international agency to intervene was not at all clear.

Mr. Ortiz wondered whether, as a procedural matter, it was appropriate at the present meeting to discuss the feasibility of establishing an agency for international debt management. That was not to say that the issue was not deserving of discussion. Indeed, he himself had proposed placing the matter on the agenda for a full discussion at some point; but it was difficult at the present meeting to react to proposals for international debt management without the benefit of background papers or analysis. His own comments on a general solution to the debt problem had focused mainly on the notion that a debt buy-back scheme was not necessarily inconsistent with the case-by-case approach. Of course, the ways in which the debt buy-back scheme could be implemented and the means of passing on the benefits of the scheme to the relevant countries, could be dealt with on a case-by-case and conditional basis.

The staff representative from the Exchange and Trade Relations Department observed that she had offered her personal views on the distinction between individual and generalized solutions only to stimulate thought for later discussion; she did not expect the Board to reach any conclusions on the matter at the present meeting.

Picking up another point raised by Mr. Ortiz on the difference between forecasts of the external environment and what he had termed the "unexpected deterioration" in that environment, the staff representative noted that projections by international institutions had to rely on static assumptions about important variables, inter alia, basic policy stance and exchange rate changes. Thus, the World Economic Outlook could not be a forecast, but indeed was appropriately called a project. The importance of making dynamic assumptions was clearly demonstrated by developments in the terms of trade, which had made the financing of outstanding debt so much more difficult. Those changes incorporated to a great extent the effects of exchange rate changes and reflected to some extent differences in market power of individual countries. Thus, for many commodity exporters, exports were denominated in dollars, while imports were denominated in the currency of the major countries of provision. As earnings had been calculated in dollars, while the deutsche mark, the French franc, the Swiss franc, and others had been the basis for the "out-go." The large exchange rate changes of recent years were reflected in the terms of trade. In that respect, international institutions could perhaps be helpful in an effort to achieve greater symmetry in the currency denomination of exports and imports.

With the exchange and interest rate fluctuations that had been ocurring and that had exacerbated financing problems, improvements were necessary in the asset/liability management of countries themselves, the staff representative continued. Additionally, however, individual countries could obtain some insulation from adverse developments in world financial markets by arranging forward cover, or at least a cap to increases in variable interest rates. While such cover would not be obtainable for the life of the loan, it could be arranged for perhaps the grace period. Although that could be expensive, the price of forward cover could presumably be part of the overall negotiation of a financing package.

In response to questions on the differences in the regulatory accounting and tax environment among countries and on the extent to which those differences might have hampered the development of a cooperative approach to the debt problem, the staff representative remarked that four areas in which progress was needed came to mind; those had been cited also in the publications of the BIS and the OECD. First, sharp differences in the degree of provisioning derived from differential tax treatment among countries. Second, and equally important in the risk-assessment systems of some countries, there were no satisfactory arrangements to upgrade countries as they implemented measures to restore their creditworthiness. In that context, Mr. Dallara had noted the problem of some smaller countries with strong adjustment programs in gaining improved access to financial resources even though they were improving their underlying creditworthiness. Third, provisioning systems in some countries took into account the point that some debt such as trade financing was regularly serviced. In other cases, no such differentiation was made. Fourth, in some countries, there were restrictions on the conversion by banks of debt into equity of nonfinancial enterprises. It should be noted, however, that the United States recently had taken some steps to ameliorate that situation.

She had taken note of the interest of some Directors the extent to which convergence in the tax and regulatory factors might increase the scope for flexibility in devising imaginative options within the menu approach, the staff representative commented. That was a subject which the staff would be following carefully during the coming months. In that connection, while she could agree with much that had been said about the limitations of the menu approach, she did wish to point out that only two years previously, no one would have thought that creditors and debtors would by now have begun to shape such innovative approaches. In particular, developments toward securitization of sovereign debt, including a deepening of secondary markets and generating bond markets, might be important for the future.

Another staff representative from the Exchange and Trade Relations Department said that he and his colleagues had taken note of Directors' calls for more technical work, including work in regulatory areas and in the evolution of financing instruments. While he would deal with most of Directors' questions on a bilateral basis outside the meeting, he did wish to respond to Mr. Donoso's remarks on the consistency between banking prospects presented in the paper under discussion and with prospects presented in the World Economic Outlook. He could assure Mr. Donoso, first, that no inconsistency existed, although it should be noted that those two series historically tracked one another poorly. The World Economic Outlook was concerned not only with bank claims but with nonbank private lending as well; and it did not include arrears to the private sector. On the other hand, the banking statistics included arrears to banks in many cases. Rough projections for bank claims in 1987 were for a swing from minus $3.5 billion in 1986 to $10 billion in 1987. That projection, which depended heavily on assumptions about disbursements to some major countries, had not been included in the paper on international banking activity. In Argentina and Mexico, disbursements of concerted lending had come through heavily in 1987; and Colombia had reached agreement with the banks on what could be termed a spontaneous loan for $1.06 billion. That accounted in part for the increase in bank claims being projected and which was not very different, as it happened, from the world economic outlook figure for 1987. If the Mexican package had not been postponed, some $3.5 billion would not have appeared in the number for 1987.

The concerted lending in question was for very large countries that had considerable bargaining power in the system, the staff representative said; it probably would not reverse the judgment of the staff that there were concerns about mustering concerted financing for smaller countries. And, assuming the deal was consummated, the return of Colombia to market access on a nonproportional and nonconcerted basis would be an isolated example among those countries that had experienced debt-servicing difficulties. Of course, Colombia was a country that had not restructured its debt and therefore did not run counter to the staff's concerns about the resumption of spontaneous flows. Finally, the Board would have an opportunity to review nondebt aspects of the capital markets at greater length and in a medium-term perspective on the basis of another paper scheduled for review between the Annual Meetings and the end of the calendar year.

A third staff representative from the Exchange and Trade Relations Department, recalling the indication by Mr. Donoso that the export credit agencies seemed to finance a smaller share of imports, noted that the agencies themselves had made the same observation based on studies they had conducted in an effort to determine why they were losing market shares. Some agencies had actually attempted to isolate the factors creating the problem, and one of the major factors isolated was the role of very large projects, which had in the past made up a very large part of the agencies' business. Also, there had apparently been some shift as between consumption and investment, and certain goods were being financed on shorter terms.

In response to a question by Mr. Zecchini, the staff representative commented that coordination between the multilateral development banks and the export credit agencies was well established; and the flow of information in the cofinancing area when institutions like the World Bank were actually involved in the financing of a project was quite good. What was new was the movement to improve coordination when, for example, the World Bank was not directly involved in the project. In a paper to the OECD Export Credit Group, the World Bank had indicated its willingness to appraise projects in which it was not directly involved, assuming of course the request of the creditor and the consent of the debtor. A number of agencies were moving to make use of the World Bank's offer, particularly with respect to important projects.

Finally, while she would of course review in detail with Mr. Salehkhou the comments of his Algerian authorities, the staff representative said that it was the staff's impression that the agencies viewed quite positively Algeria's strong adjustment efforts, which had been undertaken without requesting support from the international financial community.

The Chairman made the following summing up:

Today we have had an extensive and interesting discussion of issues arising in connection with the debt problem. Together with the forthcoming review of the World Economic Outlook, this discussion will contribute to the upcoming meetings of the Interim and Development Committees. And we will take this topic up again after the Annual Meetings.

Executive Directors, noting the longer-term nature of debt-servicing problems, stressed the importance of establishing economic and financial conditions conducive to restoring more normal creditor/debtor relations. Strong growth-oriented adjustment policies in debtor countries remain the cornerstone of any debt strategy. But coordinated policies in industrial countries relating to protectionism, growth, interest and exchange rates, and official development assistance will also be crucial.

Directors saw as one of the achievements of the past several years the progressive abatement of "systemic threat," either from the side of a single debtor or from the side of a major bank, a development which in their view was creating scope for greater flexibility in implementing the debt strategy. Thus, they affirmed that the case-by-case approach had gained in strength. Indeed, they thought that even greater diversification was needed in the available financing modalities employed by both private and official creditors.

Most Directors considered that generalized solutions did not offer the flexibility required to tailor financing flows to the particular needs of individual countries; nor did they believe that the injection of public funds as part of such a solution would constitute optimal use of those scarce resources. A few Directors, however, believed that little progress had been made in the past five years toward resolving the debt problem. Debtors remained highly vulnerable to changes in the international economic environment, and new imaginative approaches were needed to strengthen financing flows to, and improve the growth prospects of, the heavily indebted developing countries.

Most Directors considered that the present high debt burden for some developing countries called for great caution in approaches that could further increase their indebtedness. For low-income countries with protracted debt-servicing difficulties, Directors expressed the view that financial packages by private and official creditors might need to have more realistic terms involving increased concessional flows from the official sector. In this context, Directors welcomed the longer grace and repayment periods in recent Paris Club reschedulings for low-income countries. The ongoing consideration of interest rate concessions in the Paris Club for the poorest countries was commended. Directors stressed that more imaginative forms of financial relief from commercial banks would be needed. The plight of low-income countries is a subject to which the Board will return for review in greater detail when it discusses "Enhancing Bilateral and Multilateral Assistance in Support of Growth-Oriented Adjustment Programs in Low-Income Countries." Several Directors referred to the enhancement of the Structural Adjustment Facility (SAF) as an essential new element in the debt strategy vis-à-vis the low-income countries.

Many Directors expressed concern about the overall halt in commercial bank lending to developing countries. It was indeed disturbing, several said, that net repayments of $10 billion were made in 1986 by developing countries with recent debt-servicing problems. Bank agreements on new financing packages had been subject to protracted delays in several recent cases. Several Directors also noted that the resistance of minorities of banks to participation in refinancing or new money packages should not be allowed to hold up the implementation of countries' adjustment programs. The apparent reluctance of creditors to provide new financing to relatively small middle-income countries pursuing strong adjustment programs has become a point of pressing concern, and Directors stressed the need for the Fund to aid in this respect.

Directors welcomed efforts to improve the restructuring process, with the explicit adoption of the "menu approach" for Argentina. A pragmatic development of a range of financing options, which could link the diverse interests of creditors to those of the debtors, was seen as facilitating the assembling of financing packages, and, at the same time, as a step on the way to more normal creditor/debtor relations. Despite wide agreement about the appropriateness of the menu approach at the present stage of the debt strategy, a number of Directors raised questions about its scope and suggested that its development should be accelerated. Directors agreed that the elements of securitization in the package for Argentina were imaginative and welcome. But concern was expressed that the take-up of exit bonds had been so limited. They urged that the staff examine ways in which to build upon that initiative. In particular, a deepening of secondary markets, which could lay the foundation for a primary bond market for placement outside the banking sector, was considered important.

Two financing techniques attracted particular attention today: debt/equity conversions and debt buy-backs. Directors generally welcomed the introduction of debt conversion schemes in a number of highly indebted middle-income countries. They added that debt conversion offered countries the opportunity to reduce their bank debt while enabling them to benefit, at least in part, from the discounts in the secondary market. However, a number of Directors noted that such schemes needed to be carefully designed and monitored, as they might reduce available foreign exchange resources and could cause difficulties for monetary management. In the case of one low-income country--Bolivia--banks had agreed to allow buy-backs of bank claims by the Government. Directors noted that this could be an adequate option for low-income countries for which bank debt was traded at a steep discount. Some Directors noted that, within the menu, capitalization of interest could be useful, provided that it was part of a financing package. Directors discussed the spread of provisioning by banks against claims on countries with debt-servicing problems and agreed that the move would further reduce the international banking system's vulnerability. They noted recent moves to harmonize the relevant tax and supervisory framework, but it was also observed that more should be done to speed up the process of harmonization.

Directors agreed that increased private capital flows would depend on an improvement in prospects for full servicing of debt obligations over the medium term. In the meantime, they expressed concern that financial flows to developing countries would not be sufficient to support adequate economic growth.

In this connection, Directors welcomed the more open stance of export credit agencies and noted that the Paris Club's debt subordination strategy appeared to be succeeding in restoring access to export finance for potentially creditworthy countries implementing sound economic programs. Greater balance of payments financing from multilateral development banks could also contribute to improving the flows to developing countries.

The Fund's involvement, both through direct financing and its catalytic role, was viewed as crucial to implementing the debt strategy. Directors stressed that the Fund should help secure the appropriate macroeconomic and structural policy posture in industrial and developing countries and safeguard the maintenance of the free trading system. The strengthening of Fund surveillance and of the coordination strategy among industrial countries was also advocated. Several Directors also called for a larger financing role for the Fund, and for a large increase in quotas under the Ninth General Review of Quotas; some stressed the catalytic role of the Fund, while others did not particularly address those issues. Several Directors also called for the successful completion of current efforts to enhance the SAF.

In fulfilling its role, the Fund also needs to provide candid assessments of a debtor country's situation and prospects, and work closely with countries and their creditors to facilitate the process of arriving at arrangements for payment relief of a type and on a scale that could offer realistic prospects of restoring growth and external payments viability. The Fund will be confronted with challenges in the period ahead; while it must continue to demonstrate flexible and imaginative responses to these challenges, it cannot do so without the strong financial and moral support of other parties to the debt strategy.

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